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BANKING AND FINANCE IN CHINA

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By

FRANK M. TAMAGNA

With a Preface by

T. V. SOONG

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To My Parents

FOREWORD

This study forms part of the documentation of an Inquiry organized by the Institute of Pacific Relations into the problems arising from the conflict in the Far East.

It has been prepared by Frank M. Tamagna, LL.D., Ph.D., Foreign Economist, Federal Reserve Bank of New York; author of *Italy's Interests and Policies in the Far East* (1941). The study has been prepared by Dr. Tamagna in his private capacity, and it does not purport to represent the views of the institution with which he is connected.

The Study has been submitted in draft to a number of authorities, many of whom made suggestions and criticisms which were of great value in the process of revision.

Though many of the comments received have been incorporated in the final text, the above authorities do not of course accept responsibility for the study. The statements of fact or of opinion appearing herein do not represent the views of the Institute of Pacific Relations or of the Pacific Council or of any of the National Councils. Such statements are made on the sole responsibility of the author.

During 1938 the Inquiry was carried on under the general direction of Dr. J. W. Dafoe as Chairman of the Pacific Council and since 1939 under his successor, Dr. Philip C. Jessup. Every member of the International Secretariat has contributed to the research and editorial work in connection with the Inquiry, but special mention should be made of Mr. W. L. Holland, Miss Kate Mitchell and Miss Hilda Austern, who have carried the major share of this responsibility.

In the general conduct of this Inquiry into the problems arising from the conflict in the Far East the Institute has benefited by the counsel of the following Advisers:

Professor H. F. Angus of the University of British Columbia

Dr. J. B. Condliffe of the University of California

M. Etienne Dennery of the Ecole des Sciences Politiques.

These Advisers have co-operated with the Chairman and the Secretary-General in an effort to insure that the publications issued in connection with the Inquiry conform to a proper standard of sound and impartial scholarship. Each manuscript has been submitted to at least two of the Advisers and although they do not necessarily subscribe to the statements or views in this or any of the studies, they

consider this study to be a useful contribution to the subject of the Inquiry.

The purpose of this Inquiry is to relate unofficial scholarship to the problems arising from the present situation in the Far East. Its purpose is to provide members of the Institute in all countries and the members of I.P.R. Conferences with an impartial and constructive analysis of the situation in the Far East with a view to indicating the major issues, which must be considered in any future adjustment of international relations in that area. To this end, the analysis will include an account of the economic and political conditions which produced the situation existing in July 1937, with respect to China, to Japan and to the other foreign Powers concerned; an evaluation of developments during the war period which appear to indicate important trends in the policies and programs of all the Powers in relation to the Far Eastern situation; and finally, an estimate of the principal political, economic and social conditions which may be expected in a post-war period, the possible forms of adjustment which might be applied under these conditions, and the effects of such adjustments upon the countries concerned.

The Inquiry does not propose to "document" a specific plan for dealing with the Far Eastern situation. Its aim is to focus available information on the present crisis in forms which will be useful to those who lack either the time or the expert knowledge to study the vast amount of material now appearing or already published in a number of languages.

The present study, "Banking and Finance in China," falls within the framework of the third of the four general groups of studies which it is proposed to make as follows:

I. The political and economic conditions which have contributed to the present course of the policies of Western Powers in the Far East; their territorial and economic interests; the effects on their Far Eastern policies of internal economic and political developments and of developments in their foreign policies vis-à-vis other parts of the world; the probable effects of the present conflict on their positions in the Far East; their changing attitudes and policies with respect to their future relations in that area.

II. The political and economic conditions which have contributed to the present course of Japanese foreign policy and possible important future developments; the extent to which Japan's policy toward China has been influenced by Japan's geographic conditions and material resources, by special features in the political and economic organization of Japan which directly or indirectly affect the formulation of her present foreign policy, by economic and political developments in China, by the external policies of other Powers affecting Japan; the principal political, economic and social factors

which may be expected in a post-war Japan; possible and probable adjustments on the part of other nations which could aid in the solution of Japan's fundamental problems.

III. The political and economic conditions which have contributed to the present course of Chinese foreign policy and possible important future developments; Chinese unification and reconstruction, 1931-37, and steps leading toward the policy of united national resistance to Japan; the present degree of political cohesion and economic strength; effects of resistance and current developments on the position of foreign interests in China and changes in China's relations with foreign Powers; the principal political, economic and social factors which may be expected in a post-war China; possible and probable adjustments on the part of other nations which could aid in the solution of China's fundamental problems.

IV. Possible methods for the adjustment of specific problems, in the light of information and suggestions presented in the three studies outlined above; analysis of previous attempts at bilateral or multilateral adjustments of political and economic relations in the Pacific and causes of their success or failure; types of administrative procedures and controls already tried out and their relative effectiveness; the major issues likely to require international adjustment in a post-war period and the most hopeful methods which might be devised to meet them; necessary adjustments by the Powers concerned; the basic requirements of a practical system of international organization which could promote the security and peaceful development of the countries of the Pacific area.

EDWARD C. CARTER
Secretary-General

New York,
October 15, 1942

PREFACE

Few Americans or Europeans have thought of China in financial and banking terms. Pre-war China was generally regarded as a vast country densely populated by poverty-stricken farmers and fringed by a few Westernized factory cities. Since the outbreak of war, however, China's financial mobilization has been an indispensable foundation for her military effort, and her monetary and financial sacrifices have been almost as severe as her direct losses in the war itself. Though it appears but little in headlines abroad, China's struggle against the grim danger of runaway inflation is one of the most momentous problems in the Far Eastern war. A sound banking system, safeguarded and further developed, will not only facilitate China's war efforts, but will immensely simplify and aid the important process of foreign financial cooperation with China after victory is won.

To appreciate China's present financial situation, and to prepare for the problems of reconstruction, it is necessary to know what the present banking system is, and how it developed.

Traditional native banks were functioning for many generations before the advent of banking and financial reforms during the last thirty, and especially the last fifteen, years. With prophetic insight, Dr. Sun Yat-sen, founder of the Chinese Republic, foresaw the need for a thorough reorganization of China's financial, industrial, and transportation systems, and for a comprehensive plan of national reconstruction and development. Shortly after his death, the present National Government was established in Nanking. Beginning in 1928, steps were taken to reorganize the entire fiscal system with a refunding of the public debt, the consolidation of revenues, the unification of banking and currency, the establishment of tariff autonomy, and the establishment of a new system of budgetary and fiscal control.

These measures came none too soon. In 1929, the world depression began. Two years later Manchuria was invaded. Still China's finances and credit remained firm. In 1936, a rapid and difficult shift from "hard money" to a managed currency was accomplished. In 1937, Japan attacked North and Central

China, and cut off our coastal trade with the rest of the world. Emergency measures were then required to cope with the new and extraordinary burdens of the war. Throughout the war period runs the thread of banking and financial development and policy.

Until now there has been no single book to which a Western reader could turn for an account of this development. Dr. Tamagna's comprehensive and up-to-date survey is therefore especially timely. It is the result of careful work, extending over several years. This volume may stand for a number of years, therefore, as the standard work in its field.

T. V. Soong

Washington, D. C.
October 8, 1942

AUTHOR'S PREFACE

The purpose of this study is an investigation of the organization and development of banking and finance in modern China. The study consists of an Introduction, which sets forth the general scope of the investigation, and three Parts, each divided into four Chapters—dealing with the native money market (Chapters I, V, IX), the foreign money market (Chapters II, VI, X), the modern money market (Chapters III, VII, XI) and the relationship between the financial structure and the agricultural, commercial, industrial and public sectors of the Chinese economy (Chapters IV, VIII, XII).

Part I—The Historical Background: Banking in China before 1927—traces the formation of the financial institutions from the early beginnings of Chinese history to the period of transition of modern China to the National Government.

Part II—The Structure of Money Markets in China, 1927-1937—describes the organization of the three money markets, the technique of credit and the policies of Chinese and foreign banks under the National Government, during the course of a decade characterized by political peace and economic progress.

Part III—Wartime Developments: The Money Markets in China After 1937—examines the changes which occurred in the three money markets after July 1937, under the impact of the Sino-Japanese war and the prospects of post-war financial and economic reconstruction in China.

Although an effort has been made to bring the book up to date as of the middle of 1942, the conditions described refer generally to the situation existing before considerable changes had been brought about by the outbreak of the Pacific war and the Japanese occupation of the Treaty ports in China.

The basic material for this study was collected by the author during the course of a personal investigation on money and banking in China in 1936 and was presented to the Graduate Faculty of Yale University for the degree of Doctor of Philosophy in 1937. Words can hardly express the extent of the author's obligations to the late Professor James Harvey Rogers,

for advice offered during the period of planning and early preparation, and to Professor Ray Bert Westerfield, for his painstaking co-operation and criticism in all phases of the study.

The field work of investigation in China was carried on in Shanghai, Nanking, Tientsin, Peiping, Kalgan, Hankow, Canton and Hongkong. The author wishes to acknowledge the cordial assistance offered by foreign and Chinese banks, whose officials supplied him with material, information and advice. He is personally indebted to Mr. E. Kann, of Shanghai, whose files on banking and monetary problems proved of inestimable value, and to Mr. Li Ming, Chairman of the Joint Reserve Board of the Shanghai Bankers Association, whose advice in revising the manuscript and checking it for possible errors of fact was of great help. Dr. D. K. Lieu, Director of the China Institute of Economic and Statistical Research, Dr. Franklin L. Ho and Dr. H. D. Fong, Directors of the Nankai Institute of Economics, and Dr. John Lossing Buck, Professor of Agricultural Economics at the University of Nanking, all contributed information and comments. Thanks are also due to Mr. William L. Holland who gave the author access to materials collected by the Institute of Pacific Relations, and to Mr. Peter Bernstein and Miss Hilda Austern for their valuable help in editing the manuscript.

For the information supplied and the assistance rendered by numerous organizations and individuals in China and in the United States, some of which cannot be mentioned by name here, the author wishes to express his special thanks. In particular, he is indebted to the International Secretariat of the Institute of Pacific Relations for assistance, and for making possible the publication of this study. Needless to say, the author alone is responsible for any statements of fact or opinion contained in this study and their interpretation should not be construed as representing the views of the Institute of Pacific Relations, nor of any institution with which the author has been or is connected.

FRANK M. TAMAGNA

New York
September, 1942

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BANKING AND FINANCE IN CHINA

INTRODUCTION

Behind the magnificent military resistance and the outstanding economic effort of China lies the unspectacular work of financial mobilization. The Chinese banks, which in peacetime led the country on the path of modernization, in wartime provided through their branch system a network of strategic centers for the general mobilization of economic resources. Admittedly, the problems and difficulties confronting them were tremendous. Immediate ways and means had to be found for supplying credits in foreign currencies to the Government and for meeting internal war deficits several times larger than peacetime expenditures; at the same time, funds had to be provided for financing the westward movement of productive equipment, technical staff and skilled workers and for promoting rural rehabilitation, transportation facilities and industrial development in free China. For more than five consecutive years Chinese banks have been confronted with this arduous task; it is evident that, under war conditions, the required rate of credit expansion could not have been achieved without recourse to artificial creation of purchasing power. However, the rise in prices, which since the middle of 1940 has been the dominant element in China's economy, cannot be explained on monetary grounds only—for high prices are basically the result of scarcity, which reflects conditions of insufficient production, hoarding and inadequate transportation facilities.

The war experience has demonstrated the advanced degree of development reached by the Chinese credit system. At the close of the first decade of the National Government, in 1937, the trend of China's modern banks was directed toward concentration of reserves, mobilization of funds and co-ordination between the credit market and the agricultural, industrial and public sectors of the national economy; the bases were laid for long-term financing of agricultural rehabilitation, industrial development and Government outlays. The growing importance of the Chinese modern banking system was made evident by the progressive liquidation of the old-style native financial institutions and the withdrawal of foreign banks from a posi-

tion of autonomous predominance in the foreign exchange market to a position of "necessary co-operation" with China's monetary authorities. In the modern money market, the four Government banks (the Central Bank of China, the Bank of China, the Bank of Communications and the Farmers Bank of China), backed by expanding resources, the prestige gained through successful currency and exchange management and the participation of the National Government, appeared ready to assume the financial leadership of the country.

Despite the increasingly important role played by Chinese modern banks, the problems of banking and finance and the functions of credit in the economic development of China failed to attract adequate attention from Chinese and foreign economists. The reason can probably be traced to two traditional elements; namely, owing to the position of foreign banks in Treaty ports, foreign merchants had no need to establish contacts with Chinese banks, while the problems connected with the practices of money exchange were of more immediate importance in a country where silver, copper, paper, domestic and foreign currencies were promiscuously used. The monetary reform of November 3. 1935 abolished the silver standard and introduced an exchange standard managed by the Government banks; this made it possible for the Government banks to obtain control immediately of the exchange market, and to supply the war chest with considerable sums in foreign exchange and to expand indefinitely currency and credit when required by the emergency. It may be said that the monetary reform of 1935 marked the passage of China's economy from a hard money basis to a credit standard, which, though in accord with modern monetary tendencies, was admittedly novel and involved fundamental changes in the monetary and banking systems.

These problems have been approached from the long-term prospects of financial development and the significance of such development on China's peace and war economy and post-war reconstruction. In order to evaluate the relationship between banking and finance and the various other economic activities, it has been necessary to trace the formation of financial institutions and practices and to investigate the internal organization and business methods of Chinese and foreign banks. Of fundamental importance is the distribution of the banking resources and functions among three money markets—each of

which enjoys considerable autonomy in its special field of operations, no close co-ordination ever having been attempted among them.

The native money market is formed by those institutions, organizations and individuals handling, in the traditional Chinese way, business connected with monetary and financial transactions. During the course of centuries, the native money market developed in decentralized units and without national co-ordination. Native institutions originated as the product of local needs, remained independent of support or supervision from central authorities and established local self-regulating bodies (guilds) which contributed toward maintaining the decentralization of activities and certain differences in methods of management and business. Native banks and their guilds are the central institutions of the native money market; they are connected with older forms of the Chinese economy, particularly small business and industry, and in times of crisis they are the initiators of speculative movements. Despite the defects in native banking, the system has a definite place in China's financial organization.

The foreign money market was introduced into China during the second half of the XIX century and consists of those institutions and organizations which handle monetary and financial business under foreign control. Foreign banks are situated in a few Treaty ports, Shanghai being the outstanding financial center of the country; they are legally exempt from the jurisdiction and regulations of the Chinese authorities, owing to the special rights of extraterritoriality. Along with foreign exchange transactions, the activities of the foreign banks are directed toward the financing of foreign trade and foreign firms in China. Under such legal and political conditions, the foreign banks form an element which cannot easily be absorbed into China's national financial organization. This situation still exists, although the Japanese occupation of the Treaty ports has altered fundamentally the relative position of foreign banks.

The Chinese modern money market was established during the first quarter of the XX century. It comprises those institutions, organizations and associations, official and private, handling monetary transactions under the laws and regulations of the Chinese authorities and along the lines of modern Western business methods. In the course of the last fifteen years modern

banks have developed into a highly centralized financial system, closely connected with the National Government. The mercantile character of the modern banking system is made evident by the predominance of current, or short-term, liabilities. As no adequate facilities for rediscount or realization of slow assets are provided, the banks are not in a position to engage independently in large-scale long-term operations such as industrial or agricultural financing would entail.

The basic problem of Chinese banking and finance during the last fifteen years has been the need for co-ordination between the modern money market and the various sectors of the national economy. As the development of modern economic forms progressed more rapidly in banking than in other fields, modern bankers were confronted with the double task of providing funds for the traditional forms of economic activity and introducing new kinds of credit instruments for the financing of modern enterprises and the Government.

China is basically a rural country, with a fairly commercialized agriculture characterized by want of ready cash to meet consumption needs rather than productive requirements. Since banks limit their advances to productive uses and require liquidable types of security, they are not in a position to expand operations in rural financing unless productive rather than consumption credit can be distributed to farmers. Consequently, the individual money-lender, the merchant and the pawnshop are the primary sources of credit for the farmers. The terms and conditions under which this credit is granted vary greatly in the various districts and according to the particular nature of the lenders and borrowers, but usury is the characteristic evil of the countryside. This basic situation assumed a critical trend during the early 'thirties, when the outflow of silver from the interior to Shanghai exerted a deflationary pressure upon China's rural economy not dissimilar to that arising during the 'twenties in the United States as a result of the movement of funds from the rural areas to the capital markets. Late in the 'thirties, however, the financial plight of China's rural communities was, on the whole, probably eased by inflation, although the war brought about a social dislocation among farmers and a deterioration in the technical productivity of the agricultural economy. It is evident that the underlying causes of borrowing for consumption (poverty, social expenses,

banditry, lawsuits) could not be eliminated merely by supplying more credit or by adopting different bank policies. However, by redirecting the flow of bank credit from the Shanghai speculative markets to the interior, interest rates could be reduced, the use of productive credit expanded and the rural financial burden alleviated. On the basis of these postulates, modern banks during the early 'thirties fostered the introduction of a collective type of guarantee through the rural credit co-operative societies; this, as a limited experiment for bank lending, proved successful. However, as this bank credit was granted for short terms and secured by crops, it could not be invested in permanent rural improvements, such as the introduction of crops requiring mechanized equipment, the transfer of submarginal land to normal productivity and the increase of per capita and per hectare production. In 1937 the Agricultural Credit Administration was organized by the National Government as the intermediary between the lending banks and the borrowing agricultural co-operatives. At the same time, the Farmers Bank of China was authorized to issue debentures for fixed (long-term) loans to agriculture; this right, however, was not exercised.

During the course of the war, the Agricultural Credit Administration went fairly far in the establishment of the basic structure of rural financing, and credit and banking co-operatives played a vital role in the rural mobilization of the country. On the other hand, war conditions prevented the Administration from achieving its financial aim, which was to shift private funds from China's speculative markets to the rural areas; only public funds, supplied by the four Government banks and provincial institutions, were pumped into the agricultural field. Moreover, bank and co-operative credit continued to be granted for seasonal cycles of rural production; long-term credit for investment purposes was rather insignificant and certainly not adequate to cover the needs of the country.

Despite the industrial progress that probably will be made in the immediate post-war period, China will remain chiefly a rural country, and her reconstruction from the havoc of the conflict will depend basically upon the technical rehabilitation of the rural economy. This, in turn, will depend to a very large extent upon the ability of the financial system to make long-term funds available at relatively low rates to agriculture. While

the Agricultural Credit Administration will be in a position to direct the distribution of funds, the burden of raising them will rest with the modern banks, which are the most important depositories of the nation's savings.

This agricultural situation finds a counterpart in other traditional forms of the Chinese economy; namely, small trade and small industries. Despite the lack of modern credit instruments, large-scale trade, both foreign and domestic, has never been hampered by a shortage of bank credit; modern industrial enterprises, although generally under-capitalized, have usually been in a position to obtain financial assistance from ordinary and Government banks. Even the problem of post-war reconstruction in the modern trading and industrial fields will be of an economic rather than financial character, i.e., enterprises will find it more difficult to obtain goods and equipment than bank credit. On the other hand, with the decline of native banking during the middle 'thirties, small trade and small industries were left without adequate financing agencies: these banks were the only type of institution which granted the one sort of credit (unsecured loans) that small businessmen could use. Wartime inflation has temporarily alleviated the plight of both native banking and small business. Under the impulse of the war and the penetration of new political and economic forms in the hinterland, the modernization of business practices has probably proceeded at an accelerated pace; but despite this, isolated instances of public loan offices and unsecured lending by modern banks to small firms have failed to become general and accepted policy. Thus, the problem of direct financing of small trade and small industries by modern banks still remains unsolved. The importance of this petty credit cannot be measured statistically, but is undoubtedly very great.

The role played by the leading modern banks in connection with the political unification of the country by the National Government can hardly be overemphasized. On the one hand, these modern banks, with their branches, were the only nationwide agencies for the collection of savings; as other institutions in a position to participate in public financing through savings accumulation had not developed, the burden of covering Government deficits rested entirely with the banks. On the other hand, through the handling of Government funds, modern banks became the distributors of public money throughout the

country and were in a position to participate actively in any project of economic reconstruction undertaken by the National Government. The National Government itself was not slow to recognize the decisive bearing of currency unification upon political unification, and the role of branch banking on national currency policies. Thus, the introduction of modern political and economic forms proceeded along parallel lines. The close collaboration, inaugurated in 1927 between the Shanghai bankers and the National Government, was based upon these well-founded economic and political interests.

Two outstanding and well-known personalities, Dr. T. V. Soong, former Minister of Finance and Governor of the Central Bank of China and now Chairman of the Bank of China, and Dr. H. H. Kung, Minister of Finance and Governor of the Central Bank of China, have dominated the policies of the National Government in the fields of financial reconstruction and war finance. Among the men who silently and unpretentiously carried out the obscure technical work of developing modern banking into an instrument of political unification and economic progress of the country, Chang Kia-ngau, K. P. Chen, and Li Ming have played leading roles. The name of Chang Kia-ngau is intimately associated with the rise of central banking. As vice-governor and general manager of the Bank of China from 1917 to 1935, he made it the leading public institution in the domestic market, the trusted financial agent of China abroad and the training ground for the younger generation of Chinese bankers. In 1935 he was appointed deputy-governor of the Central Bank of China. Mr. K. P. Chen, who is president of the Foreign Trade Commission and chairman of the Chinese-American-British Stabilization Board of China, is the outstanding leader in branch banking. Founder and general manager of the Shanghai Commercial and Savings Bank, he extended bank financing to industries and brought modern banking into contact with the common people of the rural areas through a widespread net of branch offices and subsidiary co-operative credit societies. Mr. Li Ming, in the management of his institution, the Chekiang Industrial Bank, adhered strictly to the practice of unit banking for foreign trade financing. As chairman of the Joint Reserve Board of the Shanghai Bankers Association, he played the leading role in the field of inter-bank co-operation and international financial relations in

the Shanghai market, fostering the establishment of organs for the mobilization of bank assets, the introduction of new credit instruments, and the development of new forms of Government and private long-term financing. These three men were responsible for the founding of the Shanghai Bankers Association, of which Mr. K. P. Chen and Mr. Li Ming were alternately chairman.

It has frequently been said that western economic institutions cannot be exactly transplanted to the Far East and that corporate business in China has usually retained, owing to the general social climate, the characteristics of partnership. Although such a statement is fundamentally correct, it needs some qualification. Even in the Western world, corporate business developed in the various countries according to the local social background and retained to various extents vestiges of the partnership type. It is natural that in China corporate business, recently imported from abroad, should go through a phase of adjustment and adaptation, during which traditional practices continue to prevail and evolve slowly under the modern forms. The introduction of capitalistic institutions, public or private as the case may be, in the field of banking has preceded similar development in other fields, and modern bankers have led all other business leaders in the use of new instruments and techniques. Far from interrupting this process, the war is facilitating it by bringing about a fundamental change in the social psychology of the Chinese people—a new sentiment of allegiance to the social group, besides, if not beyond, that given to the family, and the gradual acceptance of an objective "administration by law" instead of the traditional Confucian "administration by gentlemen." The prospect of the social and economic structure of China after the war looks very complicated indeed; but there can be no doubt that the nation is evolving rapidly and the changes are bound to be far-reaching.

PART I

The Historical Background: Banking in China Before 1927

CHAPTER I

THE NATIVE BANKS

PUBLIC CREDIT AND PUBLIC MONEY BEFORE MARCO POLO (XIII CENTURY)

The beginning of banking activities in China has been dated by some authors as far back as two thousand years, or even earlier. A common opinion is that trade relations with the Roman Empire were established by tradesmen from Shansi and that Chinese merchants taught the technicalities of bookkeeping and money-transfer to the Italians.[1] However, this is not supported by substantial evidence. Although the use of money and of paper representative of money-values was perhaps introduced into China earlier than into any other surviving civilization,[2] the Chinese economy failed to acquire the structure of a money-economy.

The use of monetary technique, however, was not entirely absent. For example, advances for ceremonial rites and for farming may have been made by the Government as early as two thousand years ago,[3] and during the Chou Dynasty (1122-256 B.C.) a bureau of currency and produce exchange (Chuan-fu) was established to make advances for consumption and for productive purposes.[4] Loans to the farmers by the Government were made under the Sung Dynasty (X century A.D.), and a famous political philosopher, Wang An-shih, was entrusted by Emperor Shen-tsung (1068-1085 A.D.) with the task of carrying out plans of social reform, among which was the establishment

[1] Jernigan, T. R., *China's Business Methods and Policy*, London, 1904, p. 92; *China in Law and Commerce*, New York, 1905, p. 275; Edkins, J., *Banking and Prices in China*, Shanghai, 1905, pp. 1, 11, 24; Wagel, S. R., *Chinese Currency and Banking*, Shanghai, 1915, pp. 145-53.

[2] The first information on the existence of paper money in China was brought to Europe by the Franciscan Friar Rubrouck and by the Italian traveler Marco Polo (XIII century A.D.). The earliest authentic form of paper money is considered to be a note issued under the Tang Dynasty, about 650 A.D. Kann, E., "Paper Money in China," *Finance and Commerce*, July 29, 1936.

[3] "The Chinese Banking System," *The People's Tribune*, February 16, 1934, p. 185.

[4] Shaw, Kin-wei, "Chinese Banking," *The China Critic*, July 19, 1928.

of a system of public pawnshops to relieve the farmers from the local money lender with loans to be repaid after the harvest at a monthly interest rate of 2 per cent.[5]

A great advance was made in 970 A.D., under the Sung Dynasty, with the opening of official bureaus handling the transfer of receipts of commodities or money deposited in the Government treasury. Even before that time there were documents which conferred authority to receive a certain quantity of Government-controlled goods, as salt, iron, tea, etc.; these documents could be transferred from city to city and redeemed at public warehouses. With the new system, merchants who had to make payments in other cities were offered the opportunity to obtain transferable receipts against deposit of metallic money, at a commission of 2 per cent; these receipts circulated as monetary documents, and severe punishments were provided against trading them at a discount.[6]

The invading Mongols took over many Government institutions founded by the Sungs, and when Marco Polo was in China (1260-1290), a system of Government stocks of grain was in operation, for distribution either as relief to distressed populations or as advances for consumption and production. Paper money was issued against certain precious goods (silver, precious stones, silk, skins) and official bureaus for redemption and exchange were established. The notes of the Venetian traveler do not indicate the existence of anything like financial institutions handling deposits, exchanges and advances of money.[7] Public activities, such as the issue of a medium of exchange and advances in kind or money for religious or social purposes, were in no way peculiar to China, nor can they be taken as indicative of the existence of a financial market. Money was chiefly used for immediate acquisition of goods for consumption purposes,

[5] The other plans called for a limitation of trade profits, a national distribution of surplus products and commodities and the substitution of an income tax in lieu of compulsory labor for public works. Edkins, J., *op. cit.*, p. 70 ff.; Shaw, Kin-wei, *Democracy and Finance in China*, New York, 1926, p. 99.

[6] Morse, H. B., *The Trade and Administration of the Chinese Empire*, Shanghai, 1908, p. 132; Jernigan, T. R., *China's Business Methods and Policy*, p. 78 ff.; Wagel, S. R., *op. cit.*, p. 150; Kann, E., "Paper Money in China," *Finance and Commerce*, August 6, 1936. The anonymous author of "The Chinese Banking System," *The People's Tribune*, dates the introduction of this system of transfers at 806 A.D.

[7] *Le Livre de Marco Polo*, Paris, 1865. See especially Chs. CII (pp. 245-46), XCVIII (p. 341), CXVI (p. 386), CXIV (p. 376), CXIX (p. 400), XCV (pp. 319-27), CLII (pp. 509-21).

directly or through loans granted by local money-lenders or by public offices; and any employment of it as a capital fund in a financial system of transactions was still undeveloped, if not unknown.

THE BEGINNING OF PRIVATE FINANCING IN THE XIII CENTURY

A more important development in the business of handling money occurred during the XIII century A.D., when private merchants went into operations which had been traditionally reserved to the Government, such as handling remittances and exchange of monetary documents. The use of paper representing money values, fostered by the system of official transactions in Government paper money, aided in spreading the custom of dealing in titles and deeds, as well as in real goods.[8] The development of trade, dating back to the Tang Dynasty (VII-X century A.D.) and expanding after the XII century with the exploitation of the coal mines of Shansi, made barter transactions increasingly obsolete.[9] The extension of the use of silver ingots in the shape of a shoe as monetary units,[10] the continuous variations in the copper-silver exchange rates,[11] the persistence of the use of gold, iron and salt as monetary media in some border

[8] Edkins, J., *op. cit.*, asserts that "the use of paper representative of money led to the development in China of a banking system" (p. 1). See also Wagel, S. R., *op. cit.*, pp. 145-46. T. R. Jernigan gives very detailed information about dealings in mortgage deeds, *China's Business Methods and Policy*, pp. 27-41, and *China in Law and Commerce*, Chapter V, pp. 132-53.

[9] The use of money, however, never supplanted barter transactions. At the time of Marco Polo, taxes and tribute were paid in silk, grain, skins, gold and silver metals and other general and precious commodities, *Le Livre de Marco Polo*, Chapter CLII, pp. 509-21. H. B. Morse gives examples of payments of tribute in silk, cotton, in grains at the close of the Empire (1911), *op. cit.*, Ch. IV., pp. 107-8. Payments of tribute in silk, cotton, grain and salt were common all through Chinese history. In the opinion of Kann, E., *The Currencies of China*, Shanghai, 1927, p. 409, the quantity of coinage in circulation was comparatively small until the Tang Dynasty (VII century) and increased later with the development of trade.

[10] In the opinion of J. Edkins, silver in the shape of the shoe was introduced only in 1276, *Chinese Currency*, Shanghai, 1901, pp. 1-25. The first coinage of silver is dated by E. Kann at 1183. *The Currencies of China*, p. 60. In the opinion of a Chinese writing in 1831, Wang Liu, "Essay on Chinese Currency," reprinted by J. Edkins in *Chinese Currency* (App. 18), silver came into use in Central China only after the VI century A.D., and in North China even later.

[11] According to J. Edkins an official rate of exchange between copper and silver was first established in 1376 (one silver tael = 1,000 copper cash). In 1696 A.D. the exchange rate was one tael = 1,750 cash, and in 1889 one tael = 1,380 cash, *Chinese Currency*, p. 13.

provinces,[12] and the unchecked depreciation of the Government paper money,[13] all developed a highly speculative and profitable exchange market. The ancient use of remittances of receipts of goods and money drafts from city to city, passing from official bureaus to private shops, gave tradesmen with high standing an easy way of going into the money business, and their experience and their power grew uninterruptedly.[14]

Developments differed in the northern and in the central-southern parts of China. In northern China, Shansi merchants achieved a position of prestige and influence during the XIII century, as their trade in silk, iron, salt and coal expanded to areas outside the province. The problem of forwarding funds to carry on trade in far away places and of returning the profits was an essential part of their business, and the Shansi firms took over the operations of remittances by necessity rather than for profit. With an extensive network of branches and agencies thus established and with the accumulation of funds derived from trade, they were soon able to assist other merchants. At an early date the Government itself entrusted to them the local administration of internal customs and the collection of taxes, the receipts of which were forwarded to the central Treasury of the Empire.[15]

In the central-southern parts of China, business organization was based upon a system of well developed, independent and

[12] At the time of Marco Polo, gold was used as a medium of exchange in Yunnan (Ch. CXVI, p. 388), and part of Szechwan (Ch. CIX. p. 400), and salt in Tibet (Ch. CXIV, p. 376). Iron was still used in Szechwan during the XI century. Edkins, J., *Currency in China,* Shanghai, 1890, p. 8, and Kann, E., "The Paper Money in China," *Finance and Commerce,* August 6, 1936. For monetary use of gold and iron in China see Kann, E., *The Currencies of China,* p. 260 ff., and pp. 411-12.

[13] The history of the successive issues of paper money in China has been written by Kann, E., "Paper Money in China," *Finance and Commerce,* July 31 and August 7, 15, 23, 31, 1936.

[14] Wagel, S. R., *Chinese Currency and Banking,* p. 145 and p. 152: "Practically all the banking business done in China up to the XII century was done by the Government." Kann, E., "Organization of Chinese Government Banks," *North China Daily News,* October 10, 1928, and "Progress of Banking in China," *The China Press,* March 15, 1936, observes that in the old times "undoubtedly banking was a prerogative of the Government." In "Chinese Native Banks," *The China Yearbook,* 1926, pp. 543-54, the same author expresses the opinion that "the metamorphosis (of the Shansi merchants) into regular bankers became pronounced and definite from 1200 A.D. onward."

[15] Wagel, S. R., *op. cit.,* pp. 153-57; Wittfogel, K. A., *Wirtschaft und Gesellschaft Chinas,* Leipzig, 1931, p. 754.

self-regulating communities of traders, contrasting with the broad scope of the operations of the Shansi merchants. The use of silver as the monetary standard was older in the south than anywhere else; casting and assaying it was traditionally entrusted to private firms and hoarding of silver was the popular form of saving. The dealers in silver were therefore called upon to exchange the copper cash, in which the daily payments were made, into silver shoes with weight and fineness guaranteed; the shoes were held as private treasure or used as a medium of exchange for larger transactions. The operations on exchanges became an important and profitable activity: local cash shops dealing in copper and silver were established everywhere, principally by people of Ningpo (Chekiang) and of Anhwei province.[16]

THE INTRODUCTION OF BANKING (XVI-XVII CENTURY)

Dealing in remittances and exchange may be considered as the beginning of native banking activity in China. It is very difficult to determine at what time the successive changes came which transformed shops doing business with remittances (called *Piao-hao*) or with silver (called *Loo-fang* or *Yin-lu*) into institutions of a more definite banking type, handling deposits and advancing loans. It seems very likely that a leading role was played by the Shansi firms, since advances to local merchants were their traditional trade practice, and they took charge at an early date of the distribution of official paper money as well as of the administration of the Imperial Treasury's funds. Such original banking operations expanded when, following the example of the Government, high officials entrusted to Shansi firms the administration of their own private wealth.[17] The early commercial credit business of the cash shops in southern China probably took the form of consignment of silver shoes,

[16] Ningpo's capitalists were traditionally famous in Central China. The Ningpo Bankers Guild traced its origin back to the establishment of the Treasury Bureaus by the Chou Dynasty (1122-255 B.C.) and to the introduction of different standard of currencies by the Han Dynasty (206 B.C.-25 A.D.), Morse, H. B., *The Guilds of China*, London, 1932, pp. 14, 41-4. Ningpo and Shaoshing capitalists from Chekiang Province were the pioneers of banking activity in Shanghai, *Chinese Economic Bulletin*, May 29, 1926.

[17] Wagel, S. R., *op. cit.*, p. 153-7.

needed for large transactions by local merchants, against a delayed payment in copper. Evidently for self-protection, cash shops took over the handling of the merchants' funds, developing thereby a system of monetary transfers by book entries.

The definite turn probably occurred during the XVII century, around the fall of the Ming Dynasty and the beginning of the Manchu Dynasty (1644 A.D.). Tradition places the first draft of secret regulations concerning the organization and the operations of banking firms, by the Confucian commentator Ku Yen-wu, at the end of the XVI century.[18] The Shuntak banking group of Canton traces its origin back to the Empire of Kang-Hsi (1662-1722 A.D.), and its official guild was probably organized before 1675, since it was first mentioned as existing at that time.[19]

DEVELOPMENTS DURING THE XIX CENTURY

The firms doing a banking business when the Manchu Dynasty fell in 1911 only came into existence at the end of the XVIII century and later.[20] According to popular tradition, the service of remittances by drafts was introduced by a Shansi merchant, Lai Li-tai, trading between Chungking and Tientsin at the time of the Empire of Chien-Lung (1736-1796).[21] This tradition, however, is in contrast to historical information and is probably a product of the pride of an important Shansi firm (Shih Sheng Chang, which claimed its foundation from Lai Li-tai). Nevertheless, it points to a period of exceptional growth among banking institutions. Over thirty of them were in existence around 1790, operating with deposits and loans, remittances and domestic exchanges, and with a chain of branches in all important trade centers. Between the end of the XVIII century and the beginning of the XIX century, Foochow (Fukien) came into prominence as a money market, with the

[18] Otte, F., "Banks and Banking in China," *Chinese Economic Journal,* March 1927, p. 235.

[19] "Native Banks in Canton," *Chinese Economic Journal,* September 1932, p. 187.

[20] Morse, H. B., *The Chronicle of the East India Company Trading in China, 1635-1834,* Oxford, 1926, Vol. 5; Yang, H. K., "The Rise and Decline of the Shansi Native Banks," *The Central Bank of China Bulletin,* December 1937, pp. 301-3.

[21] "A Chapter in Chinese Banking History," *Chinese Economic Bulletin,* July 18, 1925.

inflow of silver brought by the trade in tea,[22] and the Shanghai market was started by Ningpo and Shaoshing capitalists from Chekiang Province and Shansi bankers before it was opened as a Treaty port (1842).[23] Representatives of the Shansi bankers stated in petitions presented in 1913 and 1914 to the Peking Government that "senior firms had been in business for more than 100 years, and younger firms for more than 50 years."[24]

The different economic bases of the northern (Shansi) group and of the central-southern (Ningpo) group produced a well balanced situation, in which the former formed a national and semi-official organization and the latter developed private and local institutions. Moreover, from the beginning the two groups entered into non-competitive ranges of business, the Shansi bankers dealing with inter-provincial remittances and trade and Government services and funds, while the Ningpo group dealt with local exchanges, intra-provincial or intra-city remittances and local merchants' transactions and funds. This background explains why Shansi bankers never opposed the growth of local institutions; on the contrary, they actually helped that development by supplying the needed funds. The local institutions remained under their tutelage, and the Shansi firms became not only the Government banks, but also the bankers' banks, a situation which explains their power during the XIX century.[25] Their influence was felt to a high degree in the north and west of China, and to a lesser extent in the southeast.[26]

22 "Native Banks in Foochow," *Chinese Economic Journal,* May 1932, pp. 440-47.

23 "Native Banking in Shanghai," *Chinese Economic Bulletin,* May 29, 1926; Chu, Percy, "Native Banking in Shanghai," *North China Daily News,* March 27, 28, 1928; Chang, George H., "The Practice of Shanghai Native Banks," *The Central Bank of China Bulletin,* December 1938, p. 310.

24 Hall, R. O., *Chapters and Documents in Chinese National Banking,* Shanghai, 1917, pp. 1-10; Hall, R. O., *The Chinese National Banks from their Founding to the Moratorium,* New York, 1929, pp. 15-6.

25 Lieu, D. K., *China's Industries and Finance,* Shanghai, 1927, pp. 49-50: "In fact, the former Shansi banks were more truly reserve banks, as they held among them all the nation's reserve funds, although it was not so large as it is now."

26 Morrison, J. R., and Williams, S. W., *Chinese Commercial Guide,* Canton, I Ed., 1834, pp. 66-8; II Ed., 1844, pp. 199-205; III Ed., 1848, pp. 233-40; IV Ed., 1856, pp. 288-96; V Ed., 1863, pp. 271-2, fails to give any information about the standing of Shansi bankers in southern China. Mention is made only of a "few large institutions, with some correspondents outside of the city." Other general banking houses are mentioned as financial agents of commercial houses, with local business. For details about the importance of the Shansi banks in the various cities, see *Decennial Reports* of the Maritime Customs, Shanghai, 1882-1911.

NATIVE BANKS AFTER THE REVOLUTION OF 1911

The collapse of the Shansi banks came quite unexpectedly with the fall of the Manchu Dynasty (1911).[27] New tendencies, especially during the last quarter of the XIX century, had begun to undermine their structure. The fundamental factor was undoubtedly foreign trade. In a broad sense, it forced China into lines of modernization, with which Shansi methods did not accord. After 1840, the Taiping Rebellion and the troubles with foreign powers made it no longer possible to maintain the customary policy of meeting public expenditures on a cash basis, and after 1865 the Imperial Government began to rely upon internal loans and foreign banks.[28] The traditional relationship between the Shansi bankers and Government finances was definitely altered after 1890 by the establishment of official banks owned by Imperial or provincial authorities to handle public revenues and funds.[29] In 1898 remittances by postal money orders were opened between the cities on the seacoast; these were later extended to the interior.

Banking firms of the central-southern type, on the other hand, developed under the impulse of foreign trade.[30] They obtained high profits from the exchanges and increased their strength with the accumulation of silver and copper and the issue of bank notes.[31] They obtained call money from foreign banks and received deposits of funds from Government officials and mercantile communities. During the last quarter of the century the section of Shanghai under foreign control became the domi-

[27] On May 22, 1909, the *Peking Daily News* published an article, "The Development of Chinese Banks," highly praising the rare ability of the Shansi bankers.

[28] The first foreign loan was made in 1865, but no political loans of great importance were floated before 1895. Afterwards, the dependence of the Government upon foreign financing and foreign loans increased rapidly. In 1875 the first loan to a local administration was granted by the Hongkong and Shanghai Banking Corporation. The first attempt to raise an internal loan was made in 1894 (Merchants' Loan).

[29] The influence of the official banks on the Shansi institutions is discussed in Gory, J., *Notes on the Chinese Government Bank,* Peking, May 1908, p. 34.

[30] Financing of foreign trade became one of the chief functions of the native banks, Wagel, S. R., *Currency and Banking,* pp. 160-3 and 179-86; *Finance in China,* p. 280.

[31] Kann, E., "Paper money in China," *Finance and Commerce,* July 31, 1936, writes that the issue of notes became a regular function of private banking, without control on the part of the authorities, in the middle of the XIX century. See Jernigan, T. R., *China's Business Methods and Policy,* on the circulation and redemption of the "bills" issued by the banks.

nant money market of China. In 1875 the eighty native banks then in existence passed through the first banking crisis of modern times, only twenty of them surviving. However, at the beginning of the new century, when the Boxer uprising occurred, twenty-one Shansi and forty-five local banks were again in the market.[32] With few exceptions, the native banks passed through the stormy political events fairly safely.[33] Nevertheless, they were heavily involved in the "rubber shares" crisis of 1910, and their situation grew worse with political revolution and the collapse of the Shansi group.[34]

The underlying fact of this evolution of Chinese banking was the growing independence of the local native institutions from any national banking system, while Shansi bankers were losing their Government connection and their influence over local banks. Links between native and foreign banks were of a transitory and speculative nature, rather than along lines of a normal business relationship. Thus, after 1910 there was no longer any stable financial organization in China.

The World War brought a business boom, from which native banks benefited. The disorderly condition of the country, following the death of Yuan Shih-kai, President of the Republic of China, gave rise to very reckless banking activities, with highly speculative dealings in domestic exchanges and merchandise. Native banks enjoyed an exceptional boom, hit only locally and occasionally by military seizures or runs by noteholders for redemption in metal.[35] New native banks sprang

[32] Chu, Percy, *loc. cit.*; The Maritime Customs, *Decennial Reports,* 1892-1901, Vol. I, pp. 507-8.

[33] The *Peking Daily News,* May 22, 1909, attributed the low number of bank failures during the thirty years ending with 1909 to the influence of the guilds and to the rare ability of the Shansi bankers. In the opinion of Jernigan, T. R., *Chinese Business Methods and Policy,* pp. 95-9, this was due to the severe penalties of the Chinese law and to the control exercised by the guild. In our opinion, the main reason for the steady development of native banks during the pre-Revolutionary period is to be found in the expansion of foreign trade and exchange business.

[34] Chu, Percy, *loc. cit.* Following the Shanghai crisis and the Revolution, a critical situation developed in Wuhu and Soochow (Kiangsu), Hangchow (Chekiang), Foochow (Fukien). The Maritime Customs, *Decennial Reports,* 1902-1911, Vol. II pp. 5-6, 30, 43-4, 92; Vol. I, 383.

[35] Foochow native banks may be taken as an example. The Chien Tien group was issuing notes based on a nominal copper standard called *Dai-fook,* represented by 1,000 Foochow cash (something less than one national yuan). In 1922 the city was invaded by Cantonese troops; most of these banks were forced to close, and four of them left unredeemed notes amounting to about 1 million

up, in most cases connected with the political power of some minor military warlord, in a few cases with methods and policy taken from modern banks. These new institutions were lodged in better and larger premises and did business on a larger scale. They were bitterly opposed by the old established banks, and met with extreme difficulties in gaining the confidence of the public.[36] They were responsible for the early attempts to modernize some external technical forms of the conduct of banking, such as keeping accounts in yuan instead of in strings of cash, the reorganization of the guilds and the establishment of new native bankers' associations[37] and, in a very few cases, lending on collateral rather than on personal security.[38]

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local yuan. An Association for the Maintenance of the Money Market was created, and in 1925 about forty Chien Tien banks were issuing *Dai-fook* notes. No further runs occurred until the second half of 1926, when the Northern Punitive Expedition invaded the city. A forced loan of 50,000 local yuan was imposed upon the bankers. A run followed and about half of the forty-six banks went into bankruptcy. See "Banking Institutions and Savings Associations in Foochow," *Chinese Economic Journal,* February 1927, pp. 127-41; "Native Banks in Foochow," *ibid.,* May 1932, pp. 440-7. See also "The Wuhan Money Market," *The Chinese Economic Bulletin,* October 22, 1927, and "Hunan Money Market," *ibid.,* October 15, 1927, pp. 210 and 220. A study on notes issued by native banks is Kann, E., "Copper Notes in China," *Finance and Commerce,* November 25, and December 2-9, 1936.

[36] Old native banks in Tsinan fought a losing fight against the admission of the new institutions with army or political connections. In 1924 there were 185 native banks, 60 per cent of which were new institutions. *The Chinese Economic Monthly,* November 1924. The low prestige of the new banks may be attributed to their connections; but in Canton the new group (Szeyap) was established on a purely commercial basis by Chinese returned from overseas and it had particular difficulties in winning the confidence of the people. "Native Banks in Canton," *Chinese Economic Journal,* September 1932; "The Chinese Banking System," *The People's Tribune,* February 16, 1934, pp. 190-3.

[37] The two guilds in Shanghai agreed to co-operate for the establishment of the Native Banks Clearing Association in the early 'twenties. In Canton a new guild, *Yin Yeh King Hui,* was organized in 1923, which took over many of the operations formerly reserved to the old official guild, the *Chung Hsin Tung.* In Tsinan, the newly established banks organized themselves into a Native Bankers Association. In Hangchow a Native Bankers Association was formed along the lines of the association in Shanghai. In Hankow, money-lenders from Shansi organized themselves into the Fenchow Money Lenders Association, which took over the activities of the former Shansi Guild. Committees for the control of the money market and exchanges and a new system of clearings were set up. Local chambers of commerce, which had found particular difficulties in developing under the Manchu rule, spread everywhere, and the native bankers guilds normally formed the most important nucleus, often placing the issues of copper notes by their members under the control of the chambers.

[38] That was at least true in the case of the Szeyap native banks in Canton, and probably of the native banks organized in Shanghai by Chinese returned from overseas.

In the autumn of 1924, the opening of hostilities between armies in the two provinces of Chekiang and Kiangsu provoked a banking crisis which involved the three important money markets of Shanghai, Ningpo and Hangchow. Some institutions failed when the native bankers associations refused support; others just managed to overcome their difficulties with the help of modern banks. Foreign banks then decided to stop any further advances of call money to the native banks. The crisis was followed by a curtailment of speculative operations and by a period of extreme caution.[39] The crisis of 1924 marked a definite slowing down of the boom. In the interior of China, a series of local crises spread along with the northward march of the National Revolutionary Army, which left Canton in July 1926. During the following year, embargoes on the exports of silver were imposed by most of the provincial governments; the depreciation of the local currencies advanced rapidly, and the native banks, especially those connected with army leaders or politicians, suffered hard setbacks.[40] With the establishment of the National Government in Nanking in 1927 and the impulse given to the modernization of the country and the banking system, the native banks entered into an era of decline.

[39] Chu. Percy, *loc. cit.*

[40] The most important crisis broke out in Foochow. For the general situation of the local currencies and of the local embargoes to silver, see Kann, E., "Review of the Bullion and Exchange Markets in 1927," *Chinese Economic Journal,* March 1928, pp. 273-305.

CHAPTER II

THE FOREIGN BANKS

BRITISH MONOPOLY OF THE FOREIGN MARKET BEFORE 1890

Native banks never financed foreign trade directly nor engaged in the foreign exchange business. There was a serious need for credit institutions to be intermediaries between foreign and Chinese merchants after the opening of southern ports to free foreign intercourse in 1842. In 1848 a British-chartered Oriental Banking Corporation opened its premises in Shanghai, and "without any wholesome competition, it exercised a volition in its exchange methods which rapidly brought great wealth to the institution."[1] In 1854 a branch of the British-chartered Mercantile Bank of India, London and China came into the market, but it was not until after the Chartered Bank of India, Australia and China established a Shanghai branch in 1857 that foreign banking really began to expand. The operations of these banks consisted largely in discounting and rediscounting bills on cotton goods and opium.[2]

In 1864, a group of merchants and shipping men of Hongkong, realizing that "the banks now in China being only branches of corporations, whose headquarters are in England or India and which were founded chiefly with the view of carrying on exchange operations between these countries and China, are scarcely in a position to deal satisfactorily with the local trade, which has become so much more extensive and varied than in former years,"[3] decided to establish a new local institution, chartered under the Ordinances of Hongkong, with the name of Hongkong and Shanghai Banking Corporation. At the time of its establishment, British interests, chiefly represented by Jardine, Matheson and Company, were combined

[1] Jernigan, T. R., *China's Business Methods and Policies*, London, 1904, p. 385.

[2] "Foreign Banks in Shanghai," *Chinese Economic Journal*, January 1935, pp. 64-5.

[3] From the text of the *Resolution* of the merchants interested in the establishment of the bank. "History of the Hongkong and Shanghai Banking Corporation," *Encyclopaedia Sinica*, London, 1917, pp. 235-7.

with a German firm (Siemssen and Company), an American concern (Russell and Company) and a group of Persian merchants. The capital of the new institution was fixed at Hk$2.5 million, distributed in 20,000 shares, doubled and fully paid by 1872.

During the years between 1860 and 1870 a number of foreign banks opened branches in Shanghai, among which were the Comptoir National d'Escompte de Paris, the Central Bank of West India and some German banking houses. Most of these banks, however, withdrew from the market later on. This early development suffered a setback during following years, and although existing institutions were carrying on an expanding business after 1875, no new foreign banking houses entered the market until 1891. This was a period of complete British monopoly in foreign trade and foreign exchanges.

Between 1870 and 1890, the Hongkong and Shanghai Banking Corporation increased its capital to Hk$7.5 million in 1883 and Hk$10 million in 1890; its deposits rose from Hk$8.7 million to Hk$63.9 million. Loans to the Chinese Government were made by the Oriental Banking Corporation in 1874-1875; between 1875 and 1887, about ten loans were advanced by the Hongkong and Shanghai Banking Corporation. These loans consisted of limited sums in silver and gold, for military purposes and payment of indemnities; they carried annual interest rates from 8 per cent to 9 per cent and were regularly repaid. No pressure was exercised by the financial institutions over the Chinese Government.

EXPANSION OF INTERNATIONAL BANKING, 1890-1914

After 1891 a period of extensive expansion in foreign banking was begun. The Deutsch-Asiatische Bank was established in that year, and two British banking houses were opened and closed. In the following year the first Japanese institution, the Yokohama Specie Bank, went into the Shanghai market. Soon after the Sino-Japanese war, an agreement was signed between China and Russia for the establishment of a Russo-Chinese Bank with the immediate purpose of handling the financing of the Chinese Eastern railway in northeastern Manchuria. In 1899 the Banque de l'Indochine opened a branch in Shanghai, followed in 1902 by the Cathay Trust Company (under the

domination of the Guaranty Trust of New York), the International Banking Corporation (at first controlled and later entirely owned by the National City Bank of New York),[4] and the Banque Belge pour l'Etranger. The Nederlandsche Handel-Maatschappij opened a branch there in 1903, and the Crédit Foncier pour l'Extrème Orient in 1907. Several other minor institutions were born, grew and died in that period. In 1907 the capital of the Hongkong and Shanghai Banking Corporation was increased further to Hk$15.0 million; in the same year its deposits rose to Hk$224.1 million and its loans and rediscounts to Hk$219.6 million. Between 1890 and 1898 foreign banks entered into the Tientsin market,[5] which took a leading position as a financial center in northern China and a place second only to Shanghai among the Treaty ports.

Loans to the Chinese Government by the foreign banking firms expanded enormously after the Sino-Japanese war. Two war loans were issued by the Hongkong and Shanghai Banking Corporation; in 1895 the Cassel Loan was floated by the Chartered Bank of India, Australia and China. In the same year the Hongkong and Shanghai Banking Corporation entered into an agreement with the Deutsch-Asiatische Bank for joint financing of the Chinese Government; three loans were issued under this arrangement (in 1896 and 1898 for payments of the indemnity to Japan, and in 1905, the only loan then connected with the Boxer Indemnity). The conditions of the 1898 loan were particularly onerous, as for the first time serious limitations were placed upon China's tariffs and use of customs revenues.

Foreign banks were very active in the financing of railway construction and in the "scramble for concessions" connected with it. In 1898 the Hongkong and Shanghai Banking Corporation formed the affiliated British and Chinese Corporation, Ltd., for the financing and management of railways and industrial enterprises. These interests remained in control of the investment market during the following ten years and took over four issues for a total amount of £7.7 million at an interest rate of 5 per cent and at prices varying from 90 to 93 for each 100

[4] Phelps, C. W., *The Foreign Expansion of American Banks,* New York, 1927, pp. 147-9; Phelps, C. W., "American Banks Abroad," *Bankers' Magazine,* January 1930, pp. 26-8.

[5] "Foreign Banks in Tientsin," *Chinese Economic Journal,* October 1934, pp. 399-405.

nominal value. A somewhat similar relationship existed between the Banque Belge pour l'Etranger and the Compagnie Générale de Chemins de Fer et de Tramways en Chine (Brussels); issues made in 1903 and 1907 through this combination were subscribed by Banque de Paris et des Pays Bas. The Chartered Bank of India, Australia and China served as Far Eastern representative for the so-called "Peking group," a financial and industrial combination controlled by Lloyds Bank. The Russo-Chinese Bank, in addition to financing railway lines in Manchuria, backed a Belgian group with French capital in 1897 and took over a loan for railways in Shansi in 1900.

After 1908 the exclusive British predominance gave way to forms of associated control. In 1905 the Hongkong and Shanghai Banking Corporation and the Banque de l'Indochine formed a subsidiary company, the Chinese Central Railways Company, Ltd., and in 1908 the two banks underwrote jointly a £5 million loan. In the same year the Anglo-French group was joined by the Deutsch-Asiatische Bank, and between 1908 and 1912 the new combination underwrote railway issues amounting to about £11 million. In 1910 American interests, represented in the market by the International Banking Corporation, joined the combination for underwriting the Hukuang Railway Loan of 1911, amounting to £10 million, which, however, never materialized. In 1912 the Russo-Asiatic Bank (successor of the Russo-Chinese Bank, liquidated in 1905) and the Yokohama Specie Bank were admitted into the group as representatives of financial and political interests of their respective countries. In 1913 this first "Consortium"[6] subscribed the Reorganization Loan of the Chinese Republican Government, amounting to £25 million; on the eve of the conclusion of the negotiations the American group withdrew for political reasons, leaving the other five banks (Hongkong and Shanghai Banking Corporation, Deutsch-Asiatische Bank, Banque de l'Indochine, Yokohama Specie Bank and Russo-Asiatic Bank) as signatories of the convention.

Despite the existence of this consortium, independent institutions continued to participate actively in investments in China. The Chartered Bank of India, Australia and China played a prominent part in the £5 million Crisp Loan issued

[6] Field, F. V., *American Participation in China Consortiums*, Chicago, 1931, pp. 1-118.

in 1912; the Yokohama Specie Bank underwrote an issue in 1911 for an amount of ¥10 million; the Banque Belge pour l'Etranger arranged a loan to the Compagnie Générale de Chemins de Fer et de Tramways en Chine in 1913 for a stipulated amount of £10 million, of which only £4 million was actually issued. The Banque Industrielle de Chine, formally a Franco-Chinese joint enterprise, began its activities in 1913, and in 1914 it subscribed to a loan of 150 million French francs, of which only two-thirds were placed on the market.

JAPANESE BANKS DURING THE FIRST WORLD WAR

The outbreak of the First World War brought about important changes among foreign banks in China. The Deutsch-Asiatische Bank closed its doors in 1914, and its share of the maritime customs and salt revenues was transferred to the Hongkong and Shanghai Banking Corporation.[7] Following the Russian Revolution, the Russo-Asiatic Bank was reorganized in Paris, under French law.

Japanese banks initiated an extensive development in China during the war. A joint Sino-Japanese enterprise, the Exchange Bank of China, was organized in 1917, with capital of ¥10 million. Half of this capital was subscribed by a Japanese group controlled by the Bank of Chosen and the Bank of Taiwan, the other half by a Chinese group controlled by the Bank of China and the Bank of Communications. The Bank of Taiwan, which was expanding its activities in southern China (Fukien, Kiangsi, Kwangtung), and the Bank of Chosen, which had its principal sphere in Manchuria, went into the Shanghai market during the war. The Mitsui, Mitsubishi and Sumitomo Banks opened branches in Shanghai in 1916 and 1917. In the same year a local institution, the Shanghai Bank, was organized by a group of Japanese merchants, followed in 1920 by similar institutions in Hankow, Tsinan and Tientsin. At the end of the war, there were about twenty local institutions in Manchuria either Japanese or Sino-Japanese enterprises, most of which were established between 1916 and 1918, with a total paid-up capital of more than ¥7 million.[8]

[7] Wright, S. F., *The Collection and Disposal of Maritime and Native Customs Revenue since the Revolution of 1911*, Shanghai, 1927.

[8] Lee, F. E., *Currency, Banking and Finance in China*, Washington, 1926, p. 89; Bank of Chosen, *Economic History of Manchuria*, Seoul, 1921, pp. 262-79 and 281-99.

In 1915 the Bank of Taiwan, the Bank of Chosen and the Industrial Bank of Japan established a joint syndicate, which, through the Exchange Bank of China, became responsible for the so-called "Nishihara loans." These loans were granted to departments of the Central Government at Peking (Ministry of Communications, Ministry of Finance, others unspecified), to provincial governments (Kwangtung, Fukien, Hunan, Shantung, Chihli, Fengtien, Kirin) and to other authorities and enterprises. Of chief importance among these were the loans secured by stock of the Bank of China and the Bank of Communications, amounting to about ¥50 million. Officially all loans were made for economic purposes, actually with a view to political interests. Although the term "Nishihara loans" is limited, strictly speaking, to the loans contracted by a Mr. Nishihara, of the Bank of Chosen and personal representative in China of Premier Count Terauchi of Japan, it covers, broadly speaking, all the unsecured or inadequately secured loans made by this Japanese syndicate during the First World War. The amount of these loans is not definitely known, and Remer's estimate of approximately ¥120 million, based upon that of the Chinese Financial Readjustment Commission of 1925, is probably below the real sum advanced.[9] The policy of the syndicate also involved restrictions upon the activities of the Yokohama Specie Bank in China and the granting of new rights to the Bank of Chosen. The Yokohama Specie Bank joined other banks of the Consortium in protesting certain activities of Mr. Nishihara.[10]

AMERICAN AND OTHER FOREIGN BANKS AFTER THE FIRST WORLD WAR

At the end of the war there was much activity in American banking houses. Between 1917 and 1918 the American-Oriental Banking Corporation was incorporated under the laws of the State of Connecticut by the Raven Trust Company, an American firm in Shanghai. In 1921 the bank opened a branch in Tientsin and founded two affiliated companies; namely, the

[9] Remer, C. F., *Foreign Investments in China,* New York, 1933, pp. 540-5; Moulton, H. G., *Japan, an Economic and Financial Appraisal,* Washington, 1931, pp. 210, 531 and 535-7.

[10] Young, C. W., *Japan's Special Position in Manchuria,* Baltimore, 1931, pp. 242-4; Remer, C. F., *op. cit.,* p. 542; Bank of Chosen, *op. cit.,* pp. 280-99.

American-Oriental Banking Corporation of Szechwan, with an office in Chungking, and the American-Oriental Banking Corporation of Fukien, with offices in Foochow and Amoy. In 1922 a subsidiary, the Asia Realty Company, was established, and in 1925 the controlling interest of the group was transferred to a new institution, the American-Oriental Finance Corporation.[11]

In 1918 the Asia Banking Corporation was incorporated under the laws of the State of New York as a joint enterprise of a group of American banks headed by the Guaranty Trust Company of New York,[12] with its head office in Shanghai and branches in Canton, Peking, Tientsin, Hankow and Changsha. This bank took over the interests and assets of the Cathay Trust Company. In 1919 the Park Union Foreign Banking Corporation, a joint American-Canadian enterprise, opened a Shanghai branch, but withdrew three years later, selling its interests to the Asia Banking Corporation. The Philippine National Bank opened a branch in Shanghai in 1919 and closed it two years later, owing to heavy losses in exchange speculation. In 1921 the Equitable Trust Company of New York opened offices of its subsidiary, the Equitable Eastern Banking Corporation, at Shanghai and Hongkong, while various American interests were prominent in launching a Sino-American joint enterprise, the Bank of Commerce, China, later to be transferred to complete Chinese control and management.[13] In 1919 the American Express Company, Inc., entered the banking business in China. This unusual and short-lived development of American banking really ended in 1924, when the Asia Banking Corporation was placed in liquidation and its activities were taken over by the International Banking Corporation.

Interest in the Chinese market spread among other foreign institutions. Shortly after the war, the Credito Italiano launched the establishment of a joint enterprise, the Banca Sino-Italiana, with offices in Tientsin, Peking, Shanghai and Hankow. In 1924 the Chinese interests withdrew and the bank became a purely Italian enterprise, the Banca Italiana per la Cina, the

[11] "The American-Oriental Group," *Finance and Commerce*, December 21, 1932; Lee, E. F., *op. cit.*, pp. 96-8.

[12] Guaranty Trust Co. of New York, *Trading with China*, New York, 1919, p. 24.

[13] Text of the charter in Lee, E. F., *op. cit.*, pp. 183-6, App. A.

capital stock of which was entirely held by the Credito Italiano.[14] In 1920, the P. and O. Banking Corporation was founded by Far Eastern shipping interests, and the Netherlandsch Indische Handelsbank opened branches in various cities of southern China, and a Sino-Scandinavian bank and a Sino-Belgian institution were formed. In 1923, following the signing of a commercial treaty between China and Germany, the Deutsch-Asiatische Bank resumed operations in Peking, Tientsin and Shanghai. A new Russian bank, the Far Eastern Bank, was organized in northern Manchuria, on the basis of an agreement between the U.S.S.R. and the Peking and Mukden Governments, with the purpose of taking over the administration of the funds of the Chinese Eastern Railway from the Russo-Asiatic Bank. This bank went into voluntary liquidation in 1926 and its deposits from customs and salt revenues were transferred to the Hongkong and Shanghai Banking Corporation, the Banque pour l'Indochine and the Yokohama Specie Bank.[15] In 1918 joint French and Chinese interests founded the Société d'Epargne Franco-Chinoise, along the lines of the International Savings Society (established under French management in 1912); the new institution was turned over entirely to the Chinese partners in 1926. In 1921 the Hongkong and Shanghai Banking Corporation raised its capital to Hk$50 million, of which Hk$20 million was paid up; in the same year its deposits rose to Hk$471 million and its loans and rediscounts to Hk$405 million.

Foreign banks suffered some loss of prestige with the bankruptcy of the Banque Industrielle de la Chine, which was caused by illiquid assets, speculative investments and political maneuvers. A Société Française de Gérance de la Banque Industrielle de Chine, with an independent capital of 15 million French francs, was formed and entrusted with the task of collecting the assets of the Banque Industrielle. The liquidation of the liabilities was made according to an arrangement between the French and Chinese Governments, by which the outstanding French share of the Boxer indemnity was used to pay Far Eastern creditors of the bank. The liquidation was com-

[14] Tamagna, F. M., *Italy's Interests and Policy in the Far East,* New York, 1941, p. 12.

[15] "Report to the Ministry of Finance on the Liquidation of the Russo-Asiatic Bank," *Chinese Economic Bulletin,* January 7, 1926; Wright, S. F., *op. cit.,* pp. 1-32.

pleted in 1925, and a new institution was set up, the Banque Franco-Chinoise pour le Commerce et l'Industrie, with branches in Shanghai, Hongkong, Peking and Tientsin.[16]

American withdrawal, world war and maneuvers of the Japanese banking syndicate considerably decreased the importance of the Consortium of 1912. Toward the end of the war it seemed that conditions were favorable for its reorganization, which was achieved in October 1920. The American group was admitted again, and the number of members was enlarged perhaps beyond its needs, although some important independent syndicates continued to remain outside (Crisp and Belgian Syndicates). Japan participated with the explicitly stipulated condition of a free sphere of influence in Manchuria. China, however, never recognized the new Consortium, and when in financial need she tried to obtain loans from other sources.[17]

In 1923 a Japanese banking syndicate advanced about ¥40 million to the Chinese Government through the Yokohama Specie Bank for refunding purposes. This bank played an important part in the financial readjustments arising from the return of the Shantung province to China, and in this connection it issued two loans in 1922 and 1923, totaling ¥54 million. The Banque Belge pour l'Etranger arranged a loan from the Société Belge d'Enterprise en Chine for supply of railway material up to an amount of £3 million, of which only £800,000 was used during 1922 and 1923. In 1920-23, the Banque Belge pour l'Etranger and the Nederlandsche Handel-Maatschappij issued Chinese Treasury notes totaling 138 million Belgian francs and 31 million florins for the account of the Compagnie Générale de Chemins de Fer et de Tramways en Chine and of the Nederlandsche Syndicaat Voor Chine. The Vickers loan of £18 million was contracted through the Chartered Bank of

[16] A withdrawal of deposits from the Banque Industrielle of about a half-billion francs occurred between June and December 1920. A French banking syndicate, headed by the Banque de Paris et des Pays Bas, came temporarily to the rescue, advancing 250 million French francs which melted away rapidly. Connections with a Société Maritime du Pacifique seems to have been chiefly responsible for the losses. Against the remission of the Boxer Indemnity, the Chinese Government issued bonds to the amount of CN$43.9 million, for the purpose of paying off Far Eastern creditors. Remer, C. F., *op. cit.*, pp. 625-7; *The China Yearbook,* 1923, pp. 289-91; 1924, pp. 718-9; 1925, pp. 1296-1300.

[17] Field, F. V., *op. cit.*, pp. 118-98; Remer, C. F., *op. cit.*, pp. 328-32; Carnegie Endowment for International Peace, *The Consortium: The Official Text for the Four Powers' Agreement for a Loan to China and Relevant Documents,* Washington, 1921, p. 76.

India, Australia and China and the London Lloyds Bank in 1919. In the same year the Continental and Commercial Trust and Savings Bank of Chicago (one of the partners of the Asia Banking Corporation) issued Chinese Treasury Notes amounting to CN$55 million. In 1922 and 1925, the Banca Italiana per la Cina negotiated on behalf of the creditors a settlement of the former Austrian loans (the so-called Skoda Loan), involving £6.9 million. Foreign lending came to a standstill after 1924 when, due to defaults, the divided authority of the Consortium and the chaotic political situation, Chinese credit sank to its lowest level.

FOREIGN BANKS AND CHINA'S INTERNATIONAL ECONOMIC RELATIONS

Aside from political factors, the growth of foreign banks was chiefly due to their being the only international institutions in the field. Financing of foreign trade, transfer of foreign remittances and handling of customs and other government funds under loan contracts had to go through them; consequently, foreign banks, as a group, enjoyed a practical monopoly in the field of foreign exchange. Foreign trade expanded from CN$205,500 in 1871 to CN$3 million in 1926. According to Remer, remittances from overseas Chinese increased from an annual average of CN$9 million during the period 1871-84 to CN$200 million during the period 1914-30. Other remittances and expenditures, to and from China, such as missionary and beneficial remittances, diplomatic, tourists', students' and travelers' expenditures, amounted to about CN$250 million in 1928. Government foreign obligations and foreign investments in China required current annual outpayments amounting to CN$45 million in 1902-13 and CN$210 million in 1914-33. The international position gave foreign banks a particular advantage in dealing with specie, and Shanghai rapidly became the outstanding market for speculative operations in bullion and foreign exchanges. Last, but not least, a large quantity of fictitious exchange was transacted with any normal operation of the banks, as inpayments and outpayments were made in the current standard, while banking accounts were kept in a nominal monetary standard, such as the tael, or in foreign currencies. So large was the turnover in exchange transactions that

in some cases it formed the only important item of profit.[18] In 1916 twenty foreign banks in Shanghai formed a Foreign Exchange Bankers Association, which was presided over by the Chartered Bank of India, Australia and China, the senior institution in the field.

These banks received other advantages from their position as international institutions. They were working in a system of extraterritoriality, which exempted them from control or interference from Chinese authorities, while their own national laws and banking regulations were not strictly applied. In consequence they enjoyed a most unusual independence. They became to an increasing extent the safekeepers of the savings of officials, politicians and militarists, and some banks turned this easy flow of funds into speculative channels.

Altogether, although the foreign loan policy had come to a standstill and the reckless activities of some banks had raised some suspicion as to their soundness, the importance and the power of the foreign banks were still dominant when the new National Government called the Economic and Financial Conferences in June-July 1928, to deal with the organization of a Chinese modern banking system with a view to furthering the unification and independence of the country.

[18] U. S. Department of Commerce, *The Conduct of Business with China,* Washington, 1919, pp. 23-37; Arnold, J., *China, a Commercial and Industrial Handbook,* Washington, 1926, p. 173.

CHAPTER III

THE MODERN BANKS

EARLY ATTEMPTS AT CENTRAL BANKING

The early attempts of political reform under the Empire of Kwang-hsu (1897-98) coincided with the beginning of the Chinese modern banking system. Modern banks differed from native institutions in so far as their organization and business methods were based upon Western practices. From 1895 to 1904 several projects were drafted for currency reorganization, and the establishment of a central bank was generally considered. The first official scheme was proposed in 1895 by Mayor Hu Chu-fen of Peking, who advocated a Government bank with right of note issue under the control of the Board of Revenue. In 1896 Sheng Hsuan-huai, a prominent progressive junior official later to become Minister of Communications and Viceroy, proposed a national bank with a capital of 5 million taels, to be held by Chinese citizens only. In 1897 the Imperial Bank of China was organized along the lines of the Hongkong and Shanghai Banking Corporation, with right to issue notes in taels and yuan; a foreign manager was appointed at first.[1]

In 1902 China signed the Mackay Treaty of Commerce and Navigation with Great Britain, in which she "agreed to take steps to provide a uniform national coinage which shall be legal tender in payment of all duties, taxes and other obligations throughout the Empire, by British as well as by Chinese subjects" (Art. 2). Similar provisions were also inserted in subsequent treaties with the United States and Japan. In 1904 Sir Robert Hart, Inspector General of the Imperial Maritime Customs, urged an immediate currency reform and made proposals for the establishment, at some later time, of a Government bank, with two or three departments (public, private,

[1] Wong Kai-kah, *Banking in China*, St. Louis, 1903, pp. 29-32; Bank of China. *An Analysis of the Accounts of the Principal Chinese Banks, 1921-1931*, Shanghai, 1933, Lieu, D. K., *China's Industries and Finances*, Shanghai, 1927, p. 46. Otte, F., "Banks and Banking in China," *Chinese Economic Journal*, March 1927, pp. 234-8. The Imperial Bank of China underwent several reorganizations and is still in existence, as the Commercial Bank of China.

mint). In the same year an American official commission, formed by J. W. Jenks, H. Hanna and C. A. Conant, drafted a detailed plan for the introduction of a gold standard, providing eventually for the establishment of a national bank with right to issue banknotes along lines similar to those of the European central banks.[2]

A Chinese Government commission, appointed in 1903, reported on the "urgent importance" of the establishment of a bank on the initiative and under the control of the Board of Revenue (Hu-pu); and at the end of 1905 the Hu-pu Bank (which had been chartered in March 1904) opened for business as a central institution. This bank was organized as a limited liability company, and had an authorized capital of 4 million taels, jointly subscribed by the Government and by the public. It is significant that the first manager was a former compradore of the Hongkong and Shanghai Banking Corporation. The bank's regulations were ambiguous and inadequate; Article 2 provided for a Government control over the bank, "so in case of emergency the Government can make loans to the bank and receive interest"; for the tael notes it was specified that they should "exchange like silver, be redeemable at any bank and not be subject to disparaging rumours in exchange shops." The note issue remained very limited, however, never rising above 200,000 taels. The backbone of the bank consisted of official deposits, which amounted to 20 million taels in 1907.[3] In 1906 the Government asked Chinese merchants to subscribe the private shares of the bank and in exchange granted them special privileges in the appointment of its business managers.

Two years later the bank was reorganized with the name of Ta Ching Bank and new capital of 10 million taels. Its position was very satisfactory and its tael notes were the only paper

[2] Wagel, S. R., *Chinese Currency and Banking,* Shanghai, 1915, p. 76 ff.; Edkins, J., *Banking and Prices in China,* Shanghai, 1905, p. 37; Jernigan, T. R., *China's Business Methods, and Policy,* London, 1904, pp. 85-91; Commission on International Exchanges (H. H. Hanna, C. Conant, J. W. Jenks), *Gold Standard and International Trade: Report on the Introduction of the Gold Exchange Standard into China, the Philippine Islands, Panama and other Silver Using Countries, and on the Stability of Exchanges,* Washington, 1904, pp. 41-283.

[3] Gory, J., *Notes on the Chinese Government Bank,* Peking, 1908, p. 34; Hall, R. O., *Chapters and Documents in Chinese National Banking,* Shanghai, 1917, p. 5015, and *The Chinese National Banks, from Their Founding to the Moratorium,* New York, 1921, pp. 20-33 and App. A.

accepted by foreign banks. The new regulations were more harmonious with modern ideas: in Article 4 discounting was introduced as a function of the bank; in Article 5 the institution was granted the exclusive right of note issue (a privilege always disregarded); in Article 6 control of public funds was granted. Generally speaking, the management of the Ta Ching Bank was good, and when the rubber crisis came (1910), the bank was able to take steps to support the market.[4]

OFFICIAL AND PRIVATE BANKS BEFORE THE REVOLUTION OF 1911

In December 1907 a second official bank was chartered, the Bank of Communications, with the avowed aims of "uniting under one control steamship lines, railways, telegraphs and postal facilities and of recovering certain profits" (Petition of the President of the Board of Posts and Communications, and Article 2 of the bank's regulations of 1907). The authorized capital was fixed at 10 million taels, two fifths of which was to be subscribed by the Government and the remainder to be offered to the public. The paid-up capital was increased from 5 million taels in 1908 to 7.5 million taels in 1910. The new bank was granted the administration of the funds of the Board of Posts and Communications and the right of note issue.

At the beginning of the present century some provincial banks, established for the purpose of handling the local fiscal administration, began to reorganize along modern lines, with capital ranging from 1 million to 5 million taels; provincial banks were usually the result of a transformation of the currency, or note issue, or minting bureaus of the provincial treasuries.[5] In 1904 the Board of Revenue drafted the first banking regulations,[6] and in 1907-1908 three important banks opened for business with right of note issue, the Hsing Yieh Bank (later the National Commercial Bank), organized in Hangchow by the Chekiang Railroad Company, the Chekiang Bank (later the Chekiang Industrial Bank), a semi-provincial institution and the Ningpo Commercial and Savings Bank, a private banking firm. The first savings bank, the Hsin Chen

[4] Hall, R. O., *Chapters and Documents*, pp. 40-50 and App. D, and *The Chinese National Banks*, pp. 66-86 and App. D.

[5] Wagel, S. R., *op. cit.*, pp. 163-79.

[6] Tenney, C. D., *Memorials of the Board of Finance Relating to the Chinese Currency Reform*, Peking, 1911, pp. 31-3.

Bank, was organized in 1906 on the pattern of Japanese institutions, with offices in Peking, Shanghai, Hankow and Canton, and was followed in 1908 by the official Peking Savings Bank established by the Board of Revenue.[7] The eight modern banks existing at the end of 1910 had a total capital of 37 million taels.[8] After 1898 remittances were handled by the postal service and in 1907 a plan was drafted for a postal savings bank.[9]

New currency and banking laws were promulgated in 1910 and in the following year the crisis of the native banks and the collapse of the Shansi institutions coincided with official steps for currency and banking reform.[10] A foreign loan of £10 million was secured for this purpose, and a foreign adviser, Dr. G. Vissering, president of the Javasche Bank, drafted a plan for the introduction of a gold standard, managed by a private central bank of issue organized along European lines.[11] While this program failed, the Revolution brought about important changes and new developments among the newly established Chinese modern banks.

BANKING DEVELOPMENTS AFTER THE REVOLUTION OF 1911

With the fall of the Imperial Government, the Ta Ching Bank broke down. The Hankow branch closed first, while other branches (Changsha, Urga) declared themselves autonomous institutions and changed their names. The Shanghai branch supported the strain of the crisis by withholding funds from the head office and from the mint and resisted the order of closure when it came from Peking. On February 5, 1912 it launched a new institution, the Bank of China, but the difficulties involved in raising capital delayed its chartering until

[7] "Savings Bank Successes and Other Chinese Banks," *The China Critic,* August 29, 1908; Shen, L. Y., "A Brief History of Savings Institutions," *The Central Bank of China Bulletin,* September 1935, pp. 59-60.

[8] "Banking Institutions in China," *The Chinese Economic Monthly,* January 1926, p. 21.

[9] "The Postal Remittances and Savings Banks," *The Chinese Economic Journal,* January 1932, p. 59.

[10] The official program was to unify the currency under the Ta Ching Bank, with a silver reserve of 50 per cent behind the circulation, Tenney, C. D., *op. cit.*

[11] Vissering, G., *On Chinese Currency,* Vol. I; "The Monetary Problem," Batavia, 1912, p. 215; Vol. II: "The Banking Reform," Amsterdam, 1914, p. 299; Woodhead, H. G. W., "Doctor Vissering's Plan," *The Peking and Tientsin Times,* October 3, 11 and 12, 1921.

April 1913. The new institution had an authorized capital of CN$60 million, and was chartered for thirty years to operate as a department of the central Treasury, with the right of buying and selling public bonds upon consent of the Minister of Finance.

The early history of the Bank of China was one of bitter competition with the Bank of Communications, against which it tried in vain to uphold its legal status of sole Government central bank. The Bank of Communications had powerful political support, and in 1914 it obtained a new charter, officially recognizing it as a Government bank sharing with the Bank of China the control of public funds and the issue of banknotes. When in 1916 the Bank of Communications was unable to redeem its notes, the Government forced the Bank of China to concur in the suspension of specie payments; as in 1911, its Shanghai branch resisted the order and transferred the conduct of its affairs to two foreign trustees. Proposals to amalgamate the two banks emanated from the Bank of Communications, but were opposed by the Bank of China.[12] In 1917 the Bank of China petitioned the Government for a revision of its charter; on the advice of Japanese experts, the Government made a full cash payment on its share of CN$5 million and the merchants raised their subscription to CN$7 million. At a meeting held in February 1918 directors and supervisors were elected by the shareholders, and the governor was appointed from among the elected directors by the President of the Republic.[13] At that time both banks played a rather obscure though important role in connection with the Japanese Nishihara loans. In 1921 the paid-up capital of the Bank of China was increased to more than CN$19 million; its policies were directed toward gradually converting public shares into private shares and thus transforming the bank from an official department into a private limited liability corporation.

After 1911, the number of modern banking institutions increased steadily. At the beginning of the First World War

[12] Kann, E., "Organization of Chinese Government Banks," *The North China Daily News*, October 10, 1928; Hall, R. O., *Chapters and Documents*, p. 72; *The Chinese National Banks*, p. 291.

[13] Sou Hi-suen, *Etude sur la Banque de Chine*, Paris, 1920, p. 281; Chiang Kia-ngau, "The Bank of China"; Remer, C. F., *Readings in Economics for China*, Shanghai, 1932, pp. 258-366; "The Bank of China," *China Yearbook*, 1921-22, p. 280.

(1914), there were seventeen banks with a total capital of CN$124 million. By 1918, this number had grown to thirty-seven banks with a total capital of CN$179 million, and in 1926 there were 102 banks with capital aggregating CN$375 million, of which CN$158 million was paid up. Although bank offices were concentrated in a few provinces (Chihli, Shantung, Kiangsu, Chekiang, Hupeh, Kwangtung and Kiangsi), their activities were already well extended all over the country.

Some of this mushroom growth did not last long, and particularly unfortunate was the fate of provincial institutions established by warlords to finance their armies through a chronic use of paper money. The prime example was the Chung Hwa Bank, set up by Dr. Sun Yat-sen in Nanking in 1911 to finance the Revolutionary Military Headquarters at Shanghai; the bank underwent a reorganization two years later, when Dr. Sun was forced to leave China.[14]

During the chaotic years following 1916, provincial banks came under the domination of warlords, who used them to issue "Military Rehabilitation" or "Anti-Red Campaign" notes, with no backing other than the force of their armies. The provincial banks of Fukien (closed in 1922, reopened temporarily in 1926-27), of Szechwan (operating for a few months in 1923), of Chihli (closed in 1927, later liquidated), of Shansi (opened in 1919), of Honan (suspended in 1924, then closed), of Shantung (opened in 1925), of Yunnan (Fu-Tien Bank, opened in 1912, reorganized in 1929)[15] were the chief offenders of all banking practices during the 'twenties, but the most notorious example undoubtedly was the Frontier Bank. This institution was established in Peking in 1920 by General Hsu Shu-tseng and taken over by a syndicate headed by Marshal Chang Tso-lin in 1924, shortly after he occupied Peking as the Northeastern Frontier Defense Commissioner. The Chahar Industrial Development Bank and the Three Eastern Provinces Bank were also brought

[14] Bank of China, "A Brief History of the Chung Hwa Bank," *op. cit.*, p. 124.

[15] Information on provincial banks was gathered chiefly from "Financial Notes," *Chinese Economic Bulletin:* Bank of Fukien: Vol. IX, 1926, p. 145; Vol. X, 1927, p. 65; Vol. XI, 1927, pp. 19, 38; Bank of Szechwan: Vol. XXVII, 1935, p. 369; Bank of Chihli: Vol. XII, 1928, p. 65; Vol. XIII, 1928, p. 82; Bank of Shansi: Vol. XII, 1928, p. 246; Vol. XIII, 1928, p. 51; Bank of Honan: Kann, E., "Review of the Bullion and Exchange Markets in 1927," *Chinese Economic Journal,* March 1928, p. 303; Bank of Shantung: Vol. VI, 1925, p. 15; Vol. VII, 1925, p. 146; Vol. XIII, 1926, p. 151; Bank of China, *The Chinese Bankers Yearbook,* Shanghai, 1936 (for Shansi, Shantung and Fu-Tien Banks).

under his control. These three institutions flooded the market with steadily depreciating paper notes which were used for speculation in soya beans. When in 1928 the Marshal was forced to retreat to Mukden, the head offices of the banks were moved from Peking to the new capital, but no provisions were made for the liabilities left behind.[16]

This situation was, however, more or less general, and E. Kann, reviewing the money market during 1927, wrote that "all the provinces of China, with the possible exception of Kiangsu and Chekiang, are suffering in a similar way, being saddled with paper money for which there is no metallic reserve and for the redemption of which no one seems to assume liability."[17]

At an early date a few modern private banks assumed a leading position in the market. In 1914 the Young Brothers Banking Corporation was started in Chungking as a mixed native-modern institution. The Shanghai Commercial and Savings Bank opened for modest business in 1915, established the first Chinese foreign exchange department in 1917, set up an independent savings department in 1922 and in 1923 started a travel department, which in 1927 was transformed into a subsidiary company, the China Travel Service. The Kincheng Banking Corporation was established in 1917 in Tientsin and opened a savings department in 1922. In 1918 the Central Government promoted the establishment of the Agricultural and Industrial Bank of China in Peking, and in 1919 it participated in financing the National Industrial Bank of China in Tientsin. In the same year the Continental Bank of China was opened for business in Tientsin.

A stimulus toward a further development of modern banking came from overseas Chinese. The Bank of Canton was established in 1912 in Hongkong by Chinese residents of the United States. In 1920 Chinese merchants of the Philippine Islands formed the China Banking Corporation. The China and South

[16] *Chinese Economic Bulletin,* Vol. XII, 1928, p. 311; Vol. VI, 1925, p. 55; South Manchuria Railway Co., *Report on Progress in Manchuria,* Dairen (I, 1908-1928; II, to 1930); Tsao Lien, "Currency System in Manchuria," *Chinese Economic Journal,* April 1930, pp. 375-91.

[17] Kann, E., "Review of the Bullion and Exchange Markets in 1927," *Chinese Economic Journal,* March 1928, pp. 273-305. The situation of the provincial banks was still unchanged in 1928. Kann, E., "Review of the Bullion, Exchange and Financial Markets," *Chinese Economic Journal,* February 1929, pp. 89-125.

Sea Bank was founded in 1921 in Shanghai by a retired Chinese merchant of the South Sea Islands. Chinese from Hongkong started the Bank of East Asia in 1919.

SPECIAL INSTITUTIONS AND CO-OPERATIVE ASSOCIATIONS

Special institutions were also promoted. The Sin Hua Savings Bank was established in 1914 by the Ministry of Finance as a subsidiary of the Bank of China and of the Bank of Communications. In 1919 the Chinese Post Office opened the Postal Savings Bank, which rapidly expanded to 345 branches in 1926.[18] Two trust companies were organized in 1921, and in 1923 the Yien Yieh (Salt) Commercial Bank, the China and South Sea Bank, the Kincheng Banking Corporation and the Continental Bank joined to form the Joint Savings Society. A unique bank was founded in 1924, the Woman's Commercial and Savings Bank of Shanghai, in which a majority of staff and customers were women.[19]

Credit co-operatives on a western basis were started, as an experiment, by the Futan University of Shanghai in 1919 and by the Department of Agricultural Economics of the University of Nanking in 1923. In 1921 the Hupeh Committee of the China International Famine Relief Commission initiated a policy of making collective loans from its outstanding balances; in 1923 the Commission set up a Committee on Rural Co-operatives. The work done was partly educational (to promote the formation of co-operatives among farmers) and partly supervisory (consisting of recognizing co-operatives having certain standards and of granting them credits). In 1927 there were 584 co-operative credit associations, one-fifth of which were recognized by the C.I.F.R.C.; 561 were located in Chihli, the remainder in Kiangsu and Anhwei. In 1926 the provincial Government of Shantung and Chekiang issued the first regulations of co-operative associations.[20]

[18] "The Postal Remittances and Savings Bank," *Chinese Economic Journal*, January 1932, pp. 59-63.

[19] A first example was the Women's Commercial and Savings Bank of Peking, closed in 1925. Shen, L. Y., *loc. cit.*, p. 63; Gould, R., "A Bank for Women," *Banking*, New York, April 1936, p. 58.

[20] Hsu, P. C., *Rural Co-operatives in China*, Honolulu, 1929, p. 16; Chen, L. M., *The Co-operative Movement in China*, Nanking, September 1, 1936, pp. 1-11; China International Famine Relief Commission, *Rural Co-operative Credit in*

INTER-BANK CO-OPERATION AND GOVERNMENT REGULATION

Examples of co-operation among modern banks developed at an early date. In 1917 the Shanghai Bankers Association was formed, followed by local associations in Peking, Hankow and other cities, and in 1920 a National Bankers Association was organized. In 1921 the new association passed resolutions for currency reform and played an effective part in promoting a Chinese Bankers Consortium, headed by the Bank of China, for collective dealing in lending operations with the Government.[21] Moreover, the association represented all Chinese banks collectively in the bankruptcy of the Banque Industrielle de Chine and in the liquidation of the Russo-Asiatic Bank,[22] it took part in the drafting of banking regulations in 1921, and promoted the adoption of standard accounting based on the double entry system.[23] In 1919 the Shanghai Bankers Association established a Joint Reserve Fund, with a sum of CN$300,000, deposited with the Bank of China "as a protection against any emergency in any of the banks."[24]

Chinese bankers were not successful in their attempts to organize a modern stock exchange. The China Merchants Stock Exchange in Shanghai failed to develop as a share market. The attention of its members was devoted exclusively to Government bonds, so that it became known as the "Government Bond Exchange."

Outside the foreign concessions, Chinese banks were always regulated by Chinese laws;[25] an agreement between the National Government and the Consular Body for the administration of the Chinese laws in relation to Chinese banks operating in the

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China, Peking, April 1926, p. 28; China International Famine Relief Commission, *Annual Report,* Peking (1922, pp. 9, 56, 57; 1923, pp. 1, 4; 1924, pp. 2, 33; 1925, p. 29; 1926, p. 3; 1927, p. 9).

[21] Lee, F. E., *Currency, Banking and Finance in China,* Washington, 1926, pp. 82-4 (Bankers Association), p. 66 (Currency Proposals); pp. 180-83 (Member Banks of the Consortium).

[22] Lieu, D. K., *China Industries and Finance,* Shanghai, 1927, pp. 59-60.

[23] Otte, F., *loc. cit.,* pp. 234-8.

[24] *The China Press,* March 11, 1919.

[25] Lee, F. E., "New Banking Law for China," and "Application of the New Banking Law for China," *Barron's,* August 3, 1931 and August 22, 1932. The Shanghai Branch of the Bank of China often resisted orders from the Head Office or the Central Government, defending its position behind extraterritorial privileges.

foreign concessions was reached only in 1929. In 1914 the Chinese Government promulgated the Chinese Companies Law, on the pattern of the Japanese law, regulating four types of commercial enterprises; namely, the unlimited partnership, the limited partnership (for general and special partners), the partly limited corporation (unlimited liability for general partners and limited for shareholders) and the fully limited corporation. In 1921, the Ministry of Finance issued special banking regulations, also framed on the basis of the Japanese law, which required banks to have a minimum capital of CN$200,000. Like the bank note regulations of 1915, these laws were never generally enforced.[26]

THE BUSINESS OF MODERN BANKS

Modern institutions, forced by the lack of an extensive modern economic market in which to operate and a shortage of modern commercial paper (trade bills and marketable securities) with which to deal, developed a system of advances to industries in the form of overdrafts or loans secured by merchandise deposited in warehouses or by mortgages on factory sites. Unfortunately, no data are available on such operations.[27]

Government financing became an important operation after 1914, when the Third and Fourth Year Loans (amounting to CN$24 million each) were over-subscribed, the Bank of China and the Bank of Communications obtaining 35 per cent and 22 per cent, respectively, of the total amount.[28] According to E. Kann, twenty-seven loans were issued by the Peking Government between 1913 and 1926, with a total face value of CN$631 million and at a nominal interest rate of 8 per cent. Detailed information regarding the extent and the methods of government financing is not available. In 1918 the Bank of China and the Bank of Communications had outstanding claims against the Government totaling CN$93 million, while their notes were depreciated to 60 per cent of face value. In order to settle the claims and reorganize the currency, the Government offered two

[26] The Text of the 1915 and 1921 regulations can be found in Lee, F. E., *op. cit.*, pp. 104-8.

[27] Lieu, D. K., *op. cit.*, pp. 63-6; Ting, L. G., "Chinese Modern Banks and the Finance of Government and Industry," *Nankai Economic and Social Quarterly*, October 1935, pp. 597-610; Fong, H. D., "Industrial Capital in China," *Nankai Economic and Social Quarterly*, April 1936, p. 68.

[28] Ting, L. G., *loc. cit.*, p. 587.

loans to be subscribed for with depreciated notes and redeemed in cash at par. Large profits were expected by the banks from this method of redemption of paper currency, which was repeated in 1920. Government loans were generally placed through a banking syndicate, but in 1922 the Bank of China was the sole subscriber of the Eleven Year Short-Term National Loan of CN$10 million, secured by the former Russian share of the Boxer Indemnity.[29]

In addition to the handling of new issues, the banks also made direct advances to the Government. The Financial Readjustment Commission of 1923 estimated the aggregate amount of accrued interest and of short-term loans and advances from banks at CN$83 million, with interest rates ranging from 0.7 per cent to 1.8 per cent a month. The Bank of China and the Bank of Communications, of course, managed the largest portion, the remainder being handled by numerous native and modern banks.[30] Part of these advances was apparently made on a 50 per cent margin on the par value of bonds, which were delivered to the banks only when their market value rose to 70 per cent of par value. According to some sources, the Government sold parcels of bonds to private speculators at prices as low as 20 per cent of face value.[31]

Generally speaking, it may be said that the rapid growth of Chinese modern banks was connected with Government financing, while native banks continued to hold the bulk of domestic trade, and foreign banks remained in control of international transactions. Modern banks were meeting particular difficulty in financing internal trade on collateral security, owing to the system of personal loans granted by native banks,[32] and they were unable to make any gains in the field of foreign trade and foreign exchanges, due to their lack of equipment and to the special privileges of the foreign banks.[33] Therefore, in spite of

[29] Kann, E., Baylin, J. R., *Chinese Internal Loans*, Peiping, 1929, p. 39; Kann, E., *The History of Chinese Internal Loan Issues*, Shanghai, 1934, p. 104.

[30] *The China Yearbook*, 1924: pp. 742-91, "Report by Lo Wen-kan on Financial Readjustment"; 1925: pp. 731-761, "Tables by the Ministry of Finance of Foreign and Domestic Debts"; 1926: pp. 439-87, "Provisional Estimates of the Commission for Financial Readjustment."

[31] Ting, L. G., *loc. cit.*, pp. 590-2.

[32] Va, Y. C., "Why Chinese Native Banks Are More Powerful than the Modern Banks," *Chinese Economic Bulletin*, March 13, 1926.

[33] The "privileges" of the foreign banks were emphasized by Lieu, D. K., *op. cit.*, pp. 46-50.

their rapid growth, the importance of the modern banking institutions was still slight when the Kuomintang took over the Government in 1927. At that critical time, the future of the modern banks depended chiefly on the success of the political and economic program of the Kuomintang; i.e., the unification, modernization and independence of the country.

CHAPTER IV

THE TRANSITION TO NATIONALIST CHINA

THE GENERAL BANKING SITUATION IN 1926

The banking situation of China in 1926 may be briefly summarized as follows:

Native banks relied for their financial requirements on the irregular flow of call money from foreign banks. They were coming out of a boom brought about by the First World War, and reaping profits from speculation. Although they lacked any central or national organization and were intrinsically weak, these banks provided a general intermediary of credit for domestic trade and held the ganglions of the financial lines of the country.

Despite the fact that foreign lending had come to a standstill and even though their political influence had suffered somewhat from the events of the First World War, foreign banks continued to enjoy a dominating position derived from their international and extraterritorial status. They were holding, without cost or at a very low rate of interest, official funds (customs and salt revenues) and private funds (of politicians and militarists). With these resources, they represented the decisive factor during emergencies in the financial market. Moreover, foreign banks, as a group, maintained a monopoly over the international transactions of the country and control over the foreign exchanges, out of which they were obtaining handsome profits.

On the whole, modern banking developed by leaps and bounds, with direct or indirect official backing. It lacked, however, a modern economic market in which to operate; it was handicapped in competing with foreign banks by the higher cost of its funds, and, owing to the limited sphere of business, it was excluded from any substantial participation in the profitable financing of foreign trade. Moreover, as a result of its impersonal and technical rules derived from Western methods, the modern banks were not fit to match the extremely personal procedure applied by native banks. In addition, they lacked a central organization equipped to liquidate their assets (con-

sisting mostly of Government bonds, advances on goods deposited in go-downs and loans on mortgages) in case of emergency.

THE ECONOMIC PHILOSOPHY OF SUN YAT-SEN

With the progressive introduction of new economic methods, continued even amidst civil wars, the trend in China appeared to be decidedly favorable to the further development of the modern type of banking. After 1927-28 this trend received the support of an official policy directed toward the country's modernization, unification and independence.

It is impossible to overestimate the tremendous influence exerted by the Three People's Principles (*San Min Chu I*, or Nationality, Democracy, Livelihood) of Dr. Sun Yat-sen.[1] Although his economic theories are questionable from a scientific point of view, they had the merit of tracing the lines along which a practical policy could be developed. Dr. Sun laid down a fundamentally important program in 1918-21, to develop "the vast resources of China . . . internationally, under a socialistic scheme, for the good of the world in general and of the Chinese people in particular."[2] The proposal embraced the development of a communications and commercial harbors system, the building of modern cities, the fullest utilization of water power, the establishment of mining and heavy industries, the modernization of agricultural methods with irrigation works and reforestation, and colonization projects in Manchuria, Mongolia, Sinkiang, Kokonor and Tibet. In order to shorten the period of economic transition, Sun Yat-sen welcomed the assistance of foreign capital and the advice of foreign experts. International loans were to be raised for a definite period, during which the enterprises were to be managed and supervised by foreign experts employed by the Chinese Government. Provision, however, was to be made to train Chinese to take their places, as foreigners were to be employed only in exceptional cases after the amortization of the loans.

Such a vision of China exerted a practical influence upon the many plans drawn by the National and provincial Govern-

[1] Sun Yat-sen, *San Min Chu I: the Three Principles of the People*, Shanghai, 1927, p. 514; Hsu, L. S., *Sun Yat-sen: His Political and Social Ideals*, Los Angeles, 1933, p. 305.

[2] Sun Yat-sen, *The International Development of China*, Shanghai, 1922, 1929, p. 265.

ments, and generally upon the actual economic policy, necessarily not so precipitous but nevertheless continuous, carried on by central and local authorities. The need of state economic planning was emphasized in the Report of the Minister of Finance for the fiscal year 1929-30 in the following terms:

With a co-ordinated and purposeful activity within the Government, where it is made a unified and effective instrument to serve the Nation, the financial resources available within the country itself for constructive development will prove to be greater than is ordinarily realized.

In 1933 the National Economic Council was formed to elaborate, co-ordinate and apply a comprehensive program of reconstruction. The work subsequently done by this organization (with some assistance from experts of the League of Nations) has been highly remarkable, especially in road building, water conservancy, rural improvement and public health.

Even more directly, however, Sun Yat-sen called the attention of young China to the necessity of developing a national modern banking system. Foreign banks were decried as "another example of foreign economic invasion." He called particular attention to three activities of foreign banks: the issuance of bank notes, the operations on exchanges and the accumulation of deposits.

The credit of the Chinese bank notes [he observed] and now of the Chinese silver is inferior to that of the foreign bank notes. . . . When we buy a draft to be drawn on another city on a foreign bank, besides the commission of ½ per cent charged, the bank usually gets a profit of 2 to 3 per cent by discounting the money at both places. [In the case of deposits] foreign banks make a profit of tens of millions by using the Chinese capital through only a little business routine. . . . Two billions of deposits with foreign banks bear a very low rate of interest, at most 4 to 5 per cent. In turn the banks lend the money to the Chinese merchants at a much higher rate of interest, from a minimum rate of 7 to 8 per cent to over 10 per cent. . . . Friends, what a loss to us! . . . Foreign banks squeeze out of this country at least CN$10 million every year for the three items mentioned. . . . We have to suffer such a great loss because we have been poisoned by the foreigner's economic intrigues.[8]

The accuracy of Sun Yat-sen's estimate of the loss that China had to incur is irrelevant. The importance of his statement lies in its political implications rather than in its exactness.

[8] Sun Yat-sen, "The Political and Economic Forces," in Hsu, L. S., *op. cit.*, pp. 180-98.

THE FIRST CENTRAL BANK OF CHINA IN CANTON

When, in 1923, Sun Yat-sen and his party succeeded in attaining power in Canton, they were not slow to recognize that their existence and progress were both intimately connected with adequate financial security. Their first endeavors were directed toward establishing a Government bank on modern lines. The plans were carefully worked out and the charter was personally framed by Sun Yat-sen, but it took more than a year before the bank could open. As no working capital could be raised locally, it was finally procured in the shape of a loan from customs funds for 10 million local yuan in silver.

On August 15, 1924 the first Central Bank of China opened its doors at Canton. The charter provided for a Government-owned institution, "to develop industry, to stabilize commerce, to render financial help to the public and to encourage international trade" (Art. 1). Besides acting as fiscal agent for the Government (Arts. 7-8), the bank was allowed to transact general banking and exchange business and to deal in Government and Government-secured debentures (Art. 5). Loans on investments in real estate or real estate companies were specifically prohibited, as well as the purchase or acceptance of merchandise as security for loans (Art. 9). Loans to the Government were limited to 20 per cent of the capital and for a term of not over six months; they were to be "adequately secured or guaranteed" and "used in profitable enterprises" (Art. 6). The Government assumed liability for the money collected by the bank (Art. 15). From the beginning, the institution had the privilege of issuing bank notes, but the issue department was set up as a unit independent from the banking department.

This Central Bank of China gained good standing among the people, and although runs occurred and its notes were often circulated at a discount, it was normally able to meet all demands by ready disbursement of silver. When, in 1926, the Revolutionary National Army started the Northern Punitive Expedition, new branches of the bank were spread along its way. Eventually the head office was transferred to Hankow, where military necessities brought about a tremendous issue of valueless paper, settled in 1928 with the issue of CN$45 million of long term Government bonds, at 2.5 per cent interest.[4] The

[4] Kann, E., "The Banknotes Policy of Present-day China," *North China Daily News*, December 12, 1928.

Canton institution was reorganized in 1929 as a provincial Government institution.[5]

T. V. SOONG AND THE FINANCIAL POLICY OF THE KUOMINTANG

The first Manager of this "baby" Central Bank of China was the brother-in-law of Dr. Sun Yat-sen, Dr. Tze-ven Soong. Minister of Finance successively with the Canton, Hankow and Nanking Governments, founder and head of the Central Bank of China of the National Government, he rose to undisputed leadership by successfully financing the military victory of his party and the processes of political unification, progressive economic development and financial autonomy of China. Although he resigned from the Ministry of Finance in October 1933, he continued to serve his country in various important unofficial and official capacities. Holcombe described him as the leading representative of China's new "Spirit of Capitalism."[6] Especially in the decade before the present war, Dr. Soong was, in fact, largely responsible for the modernization and civil control of China's financial and banking systems.

At the beginning of the National Government in Nanking, T. V. Soong, as Minister of Finance, advocated the necessity of obtaining the co-operation of the business world in planning and executing an economic and financial policy. Two conferences of business leaders were called in June-July 1928 (the National Economic and the National Financial Conferences), the purposes of which were stated by the Minister of Finance in his opening address in these words:

> In time of war we have perhaps been forced to resort to extraordinary means to raise funds. Now that the war is over, we shall have to raise enormous funds to rehabilitate the country, to restore peace and order, to disband the surplus troops, to restore the dilapidated railways, to care for famine-stricken areas which have served as the battlefield. We have called together responsible non-political persons, representatives of the taxpayers, to criticize us, to help us, to guide us.

He further outlined the need of currency unification, improve-

[5] Kann, E., "The Central Bank of Canton," *Chinese Economic Journal,* 1929, pp. 1017-36; Kann, E., "The Provincial Bank of Kwangtung No. 6," *Finance and Commerce,* November 20, 1940. This first Central Bank of China is not to be confused with the Central Bank of China which was organized in 1928, after the establishment of the National Government in Nanking.

[6] Holcombe, A. N., *The Spirit of the Chinese Republic,* New York, 1930, pp. 123-54.

ment in public credit, scientific reform of taxation, demarcation of national and provincial revenues and expenditures, unification of financial administration, revival of commerce and shifting of public expenditures from "wasteful to productive enterprises . . . to carry out the rehabilitation plans of our Reverend Leader Sun." The two conferences passed several resolutions on points submitted by the Minister, and specifically the Committees on Banking and Currency adopted the following proposals:

(a) National Economic Conference:

To establish a powerful central bank, on the basis of a limited liability corporation, with the sole right of note issuance, to act as a Government Treasury, and under the supervision of a Board of Supervisors to be appointed by the Government;

To establish provincial banks, one in each province, which should be forbidden to issue bank notes and whose functions should be subject to the regulations of the Central Government;

To promulgate regulations governing the organization and operation of ordinary commercial banks, foreign exchange banks, savings banks and agricultural and industrial banks, in order to promote commercial and industrial development and to protect the interest of the people.

(b) National Financial Conference:

To organize a national bank to act as the Government Treasury, with the sole right of issuing notes, and to stabilize foreign exchange;

To organize an exchange bank to act as a central clearing house for both internal and foreign exchange;

To establish agricultural and industrial banks to facilitate the country's development of industry and agriculture.

The abolition of the tael and the revision, consolidation and liquidation of the domestic and foreign debts were proposed by both conferences.

After 1928 the National Government and the business world worked in close co-operation. Not a few quarrels, however, arose between the military and the civilian groups; the question was whether unification had to be forcibly pursued at any cost, or whether it should be achieved by an evolutionary process of modernization. In the Report of the Ministry of Finance for the fiscal year 1928-29, T. V. Soong recognized that

> [the problem of] how to restrict military expenditures . . . so that the Ministry of Finance can meet expenses without further mortgaging of the future and be able to begin to provide for reconstruction and debt consolidation, reduces itself to the problem of attaining peace within the country, a problem which no single Ministry can be expected to solve.

In the following Report, for 1929-1930, a greater emphasis was placed upon the need of economic modernization of the country:

More is demanded of the Government than an abstract balanced budget. What is required is vaguely expressed in the popular mind by the word "reconstruction." . . . The national budget must not be considered as running for one fiscal year only, nor as a static and mechanical balance between receipts and payments, to be brought about through a negative policy of cutting down expenditures. A budgetary policy to be adequate to meet the needs of the time can perhaps be attained only through the adoption of a systematic and co-ordinate expansion extending through a series of years. . . . With the return of peace and order, the people require of the Government more than the mere suppression of militarism and communism. [The question mooted:] Shall we go on making military activity our major reliance for unity in China, or shall we approximate a balance of the budget and seek China's reconstruction by a systematic, if unspectacular combination of politico-military-economic treatments?

CONCLUSION

As a matter of fact, although by the end of 1929 the National flag was flown all over the country, the National Government encountered difficulties in extending its full authority into some areas and in holding those areas under control. In 1929-1930 war broke out between the National Government and the northern militarists, General Feng Yu-hsiang and General Yen Hsi-shan, and in 1930 an exhausting and fierce struggle was started against the Communist Army, from the southern to the northwestern provinces of China, with an incidental rebellion in Fukien in 1933.

After the campaign of 1934 against the Communists in Szechwan, the National Government began to rely less on the use of the military force and tried the way of political and financial settlements. This new attitude was first stated in 1934 by Wang Ching-wei, President of the Executive Yuan, in a positive though unofficial way in his book *China's Problems and Their Solution*. Since efforts to bring about national unity by force had failed, only weakening the country further and retarding the rate of progress, "our policy today aims at attaining national solidarity by the evolutionary method of Economic Reconstruction . . . Unification by Reconstruction is the settled policy of the Nationalist Government."[7] This attitude re-

[7] Wang Ching-wei, *China's Problems and Their Solution*, Shanghai, 1934, pp. 199-200.

ceived official recognition from Generalissimo Chiang Kai-shek, who advocated a fundamental economic reconstruction program as the immediate goal of the Government. "Unification by Reconstruction" became the new slogan of the Kuomintang. In 1936 Generalissimo Chiang Kai-shek was in a position to state that "the economic reconstruction of China has now already passed its period of discussion and has entered into the stage of practical application."[8]

The program adopted by the conferences of 1928 marked the lines along which the economic and financial policies of the National Government moved. Many important measures were introduced and important results achieved. In fields connected with credit problems, specific mention must be made of the recovered tariff autonomy (1929), the gradual extension of the central financial authority, the reforms of taxation, the readjustment of internal loans (1931-1932 and 1936) and of external debts (1935-1937), the suppression of the tael (1933), the currency reform (1935) and the expansion of the co-operative movement.

In all fields, "a vast change is coming over China: a modernization that, as compared with ten or even five years ago, marks many centuries," reported the American Economic Commission in 1935.[9] "The only danger," observed Sir Leith Ross, after his visit to China in 1935, "is not that China is progressing too slowly, but that she is trying to go too fast."[10] He was involuntarily paraphrasing Sir Arthur Salter, who wrote, "China should proceed by stages and not jump her stages."[11]

[8] Chiang Kai-shek, "The Economic Reconstruction of China," *North China Daily News*, October 10, 1936.

[9] *Report of the American Economic Mission to the Far East, American Trade in the Orient*, New York, 1935, p. 69 and App. p. LXVI.

[10] As quoted by *Finance and Commerce*, December 2, 1936.

[11] Salter, Sir Arthur, *China and Silver*, New York, 1934, p. 96.

PART II

The Structure of Money Markets in China, 1927-1937

CHAPTER V

THE NATIVE MONEY MARKET

THE NATIVE BANKS

The native money market may be defined as the market formed by those institutions, organizations, associations and individuals handling business connected with monetary and financial transactions in the traditional Chinese way. The native money market developed in decentralized units, without national co-ordination. At the beginning of 1937, its largest institutions were located in the commercial centers of the country and their activities did not extend beyond the limits of the district and a few outside cities. Native institutions grew up as a result of local needs, remained free from support and supervision by the Government and established local self-regulating bodies which contributed toward maintaining the decentralization of their activities and certain differences in methods.

Native banks and their guilds were the central institutions of the native money market. A native bank may be defined as a financial firm established in the form of single proprietorship or partnership by members of a family, a clan or a closed circle of friends, for the purpose of handling deposits, lending, remittances and exchange of money, with unlimited responsibility guaranteed by all resources of the proprietor or of the partners. Partner-owners of native banks varied from two to ten in number; four, five or six partners were the most common.

As a general rule, proprietor and partners did not participate directly in the management of the bank, which was entrusted to a salaried man, the manager, a person of proved ability and technical knowledge. The manager was the chief executive of the bank and was responsible to the owners for the actual results of his administration. In some cases, however, a retired manager, who rendered valuable services to the bank, or one of the largest partners, was appointed supervisory manager. This officer had no executive authority and his functions were supervising general operations and giving advice on business policy and certain important affairs of the bank. One or two assistant

managers were appointed to help the manager in the executive work, to advise him as to the conduct of business and to supervise the staff of the bank. Under the general manager and the assistant managers were the staff members, appointed either by the owners or by the general manager. The staff was usually recruited from apprentices after a normal training period of from two to five years or more, during which they received a very low salary, if any. The bank's employees were divided into two groups, the "indoor" and the "outdoor" staff, and into eight divisions, the responsible officers of which were traditionally called the "Eight Heads."

The indoor officers included a Chief Accountant, who was in charge of records, statements and reports, and calculated interest payable and receivable, etc.; a Treasurer or Cashier, who was entrusted with the custody of currencies, specie and bills of every kind, issued cash receipts and received payments, examined commercial bills and papers and signed native bank orders; a Parlor Attendant or Usher, who received customers and took care of miscellaneous business; a Chief Correspondent, in charge of all secretarial work, of letters and telegrams of transfer and of collections and payments for clients; the Yuan Cashier, an employee in charge of yuan transactions, who was introduced after 1920 to take charge of yuan accounts and of receipts and payments in silver coins and bank notes. These chief employees were assisted by associates and apprentices; the business departments absorbed the largest part of the indoor staff.

The outdoor staff was a special feature of native banks. These institutions had been traditionally opposed to public advertising, although a moderate relaxation of this rule was evident after 1920. The outdoor staff substituted open publicity by personal canvassing for deposits and loans. The other chief functions were supervision of the use of loans made by the bank, collection of information on customers and maintenance of inter-bank relations. The chiefs of the outdoor staff were the Street Runner (or Customers Man) whose functions were to solicit business, act as middleman between the bank and its clients and make credit investigations; the Market Representative, who participated in all discussions at the guild for the determination of the official native interest rate and of the official exchange rate between the local currency and the national and other currencies; and the Bank Agent, who was in

charge of the transfer of accounts and money and relations with the modern banks. The number of employees in the outdoor staff of a large native bank varied from ten to thirty, and in addition there were some apprentices, two or more messengers (who, being in charge of the transfer of money and documents outside of the bank, were required to deposit a sum as guarantee), and an undetermined number of shroffs, or employees in charge of assaying coins and handling petty exchanges. Both indoor and outdoor staffs participated in the earnings of the bank to the extent of about 20 per cent of its net profits.[1]

SOURCES OF FUNDS

Capital. Since native banks were firms with unlimited liability of the owners, their financial standing was not exactly commensurate with the declared capital. The strength of an institution was largely dependent upon the social and financial position of the owners and the personal ability of the manager. Moreover, aside from the fact that the term "native bank" is often applied to institutions other than banking firms (exchange shops, pawnshops, etc.), available data are not numerous and reliable enough to be the subject of a detailed statistical analysis. With these basic limitations in mind, data of capital of native banks for a number of years have been tabulated.

TABLE 1

DISTRIBUTION OF NATIVE BANKS

	Year	*Number*	*Lowest capital*	*Average capital*	*Highest capital*
Kiangsu				*(In national yuan)*	
Shanghai	1927	80	..	220,000	417,000
	1934	64	100,000	320,000	840,000
	1935	80	..	320,000	..
	1937	46	..	410,000	..
Nanking	1932	56	..	6,000	20,000
	1934	13	3,000	12,000	40,000
	1935	12	..	14,000	..
	1937	6	..	21,000	..
Soochow	1932	30	..	16,000	20,000
	1934	23	20,000	48,000	60,000
	1935	20	..	48,000	..
Chingkiang	1932	9	..	31,000	60,000
	1934	5	20,000	58,000	100,000

[1] Chang, George H., "A Brief Survey of Chinese Native Banks," *The Central Bank of China Bulletin,* March 1938, pp. 25-32.

TABLE 1 (*Continued*)

	Year	*Number*	*Lowest capital*	*Average capital*	*Highest capital*
				(*In national yuan*)	
Chekiang					
Ningpo	1932	115	600	31,000	120,000
	1934	65	11,000	54,000	120,000
	1935	60	..	54,000	..
Wenchow	1934	46	2,200	18,000	50,000
	1935	30	..	19,000	..
Hangchow	1937	30	..	20,000	..
Yuyao	1934	19	5,000	13,000	30,000
	1935	16	..	16,000	..
Chuhsien	1934	18	10,000	21,000	36,000
	1935	14	..	21,000	..
Hainan	1934	14	20,000	26,500	60,000
	1935	13	..	28,000	..
Lanchi	1934	12	12,000	39,000	48,000
	1935	12	..	48,000	..
Huchow	1934	12	20,000	53,000	72,000
	1935	7	..	60,000	..
Kashing	1934	8	10,000	25,000	40,000
	1935	3	..	10,000	..
Anhwei					
Wuhu	1934	10	15,000	38,000	55,000
	1935	7	..	41,000	..
Shantung					
Chefoo	1934	58	1,000	11,000	27,000
	1935	26	..	13,000	..
Tsinan	1934	29	10,000	35,000	50,000
	1935	25	..	38,000	..
Tsingtao	1937	10	..	37,000	..
Weihaiwei	1934	6	20,000	48,000	100,000
	1935	4	..	42,500	..
Hopei					
Tientsin	1937	40	..	86,000	..
Paoting	1934	14	8,000	38,000	50,000
	1935	10	..	40,000	..
Peiping	1934	10	80,000	253,000	750,000
	1935	12	..	66,000	..
	1937	9	..	73,000	..
Suiyuan					
Paotou	1934	5	50,000	60,000	70,000
	1935	10	..	104,700	..

TABLE 1 (*Continued*)

	Year	*Number*	*Lowest capital*	*Average capital*	*Highest capital*
				(*In national yuan*)	
Shansi					
Taiyuan	1934	52	3,300	51,000	500,000
	1935	28	..	49,000	..
Szechwan					
Chungking	1934	16	21,000	93,000	277,500
	1935	19	..	200,000	..
	1937	13	..	63,000	..
Hupeh					
Hankow	1937	24	..	65,000	..
Shan	1934	12	600	8,850	40,000
	1935	6	..	15,000	..
Hunan					
Changsha	1934	95	1,200	15,000	150,000
	1935	39	..	30,000	..
Kiangsi					
Kingtehchen	1934	15	10,000	31,000	45,000
	1935	13	..	28,000	..
Kinkiang	1934	14	3,000	19,000	50,000
	1935	8	..	21,000	..
Fukien					
Amoy	1934	56	1,000	59,000	500,000
	1935	47	..	85,000	..
Foochow	1931	45	50,000	..	200,000
	1934	27	30,000	53,000	100,000
	1935	27	..	49,000	..
Kwangtung					
Canton	1932	540	..	12,600	150,000
	1934	144	1,000	22,750	100,000
	1935	64	..	36,800	..
	1937	77	..	36,000	..
Swatow	1934	201	2,000	35,000	200,000
	1935	100	..	55,000	..

Sources: Djang Siao-mei, "Native Banks," *The Chinese Year Book*, 1935–1936, pp. 1445–6 Chang, F. Y., "Native Banks," *The Chinese Year Book*, 1936–1937, pp. 794–6; Young, Stonelake Y. P., "China's Banking Progress in the Past Decade," *The China Quarterly*, September 1935, p. 66; Chu, Percy, "Native Banking in Shanghai," *North China Daily News*, March 27 and 29, 1928; *Chinese Economic Bulletin*, February 10, June 29, July 27, 1926; April 19, 1927; January 7, July 14, 1928; February 2, 1929; May 19, 1934, December 14, 1935; *China Industrial Handbooks: Kiangsu*, 1933, pp. 72, 110, 116, 914, 922–5; *China Industrial Handbooks: Chekiang*, 1935, pp. 124–5, 784, 792–4; "Banking and Currency in Tsinan," *Chinese Economic Monthly*, November, 1924, p. 5; "Native Banks in Foochow," *Chinese Economic Journal*, May, 1932; pp. 440–41; "Native Banks in Canton," *Chinese Economic Journal*, September, 1932; pp. 188–9; Koken Kudo, "Parting of Ways between Chungking and Chinese Capital Seen," *Yosuko*, July 1940.

This survey shows that the business of native banks declined gradually after 1927 and that by 1936-37 the number of native banks had been cut about in half. The banks which remained in the market, however, were better capitalized than those in existence in 1927, and this is explained by (1) more frequent bankruptcies among the weakest institutions, and (2) an expansion of the partnership type accompanied by a gradual disappearance of the single proprietorship type of banks.

According to the Research Department of the Bank of China, in 1934 the aggregate of paid-up capital of all native banks (numbering nearly 1,000) amounted to less than CN$100 million, and the total assets were estimated at about eight times this amount.[2]

The figures of the declared paid-up capital do not include, however, the so-called "supplementary capital," which was, technically, a special deposit of the partners or of other persons for a long-term or not even subject to withdrawal; a fixed interest payment was made by the bank, and the depositors thereby acquired a position similar to that of limited (and silent) partners. No information is available regarding the amount of this supplementary capital. except in the case of the clearing native banks (the *Wei-wah* banks) in Shanghai during 1932. Twenty-four banks, with an aggregate capital of CN$3 million, had supplementary long term funds amounting to CN$2.8 million, ranging from one-fourth to four times the declared capital of the various institutions.[3] These figures do not necessarily represent a general average throughout the country, but undoubtedly show the extent of a fairly general practice among native banks.

Deposits. Aside from capital and supplementary capital, native banks depended largely upon the funds deposited by individuals (mostly wealthy merchants) and business firms to carry on their banking activities. Deposits were received directly at the bank's counter or collected by the outdoor staff and brokers, usually after the holiday recess and on the first bank-opening day of the Lunar new year. Deposits of the native banks were of four kinds: fixed deposits, current deposits, temporary (or mercantile) deposits, and inter-bank deposits.

Fixed deposits were funds deposited for periods from three months to one year or more, the normal term depending upon

[2] Djang Siao-mei, "Native Banks," *The Chinese Yearbook,* 1935-1936, p. 1447.
[3] *China Industrial Handbooks: Kiangsu,* 1933, pp. 920-2.

the local customs. Terms and interest rates were agreed upon at the time of the opening of the account. Interest rates from 4 to 8 per mille per month were considered normal, although they varied with the conditions of the local market. Among more recently established native banks the tendency was to introduce uniform rates, payable at certain dates. Fixed deposits were not supposed to be withdrawable before maturity, but in most cases, especially when the money market was easy, the depositor could draw on his deposit before the fixed term expired.

The distinction between fixed deposits and *current account deposits,* which were partially or fully drawable at any time on passbook or by check as agreed upon, had been introduced according to the example set by the modern banks. Deposits, payments and the issue of native money orders on behalf of the client were entered into the client's passbook. Some old institutions, however, did not maintain check service. Interest rates were customarily fixed on the basis of the monthly average of the native interest rate, less a commission of 5 per cent due to the bank; there was, however, a minimum interest rate of 2 per mille per month. The current depositor was permitted to overdraw his account on the native bank at any time. In turn, the bank usually required any individual or business firm applying for a current account to furnish first class guarantee or the recommendation of a third responsible party.

Temporary or Wei-wah accounts were often very important among the resources of the native banks. These deposits arose from the service of credit collection for the account of local merchants. The credits were usually collected in terms of *Wei-wah* yuan, which meant that they were transferred between the banks and credited to the account of the client through clearing and were cashable only one day after the due date of the notes and checks. The use of *Wei-wah* accounts was an old and fairly well established practice, which gave the banks the opportunity of holding considerable amounts of floating funds free of interest charges. In some centers (like Ningpo, in Chekiang) the native banks furnished the local merchants with special passbooks for entry of receipts and payments due to and from merchants; these debits and credits were cleared through the local guild. In some border regions (like Paotou and Kweihua on the Mongolian border), the resources of the native banks

were provided out of cash collected for the account of local merchants. This cash was credited on the following day to the merchants' accounts by notations in passbooks, and no interest was due. Wholesale transactions were settled by clearing.

Inter-bank deposits arose either from inter-bank transactions or were maintained for clearing purposes. This second type was more common. Native banks paid their checks exclusively by clearing through their guild; nonmember banks of the native clearing guild (native banks as well as modern or foreign banks) were obliged to maintain a deposit with a member native bank in order to have the privilege of cashing their credits. Deposits of this kind usually bore the daily native interest rate. With the formation of modern clearing houses in a few cities (Shanghai in 1933, Hangchow, Tientsin and Nanking between 1933 and 1936), this situation underwent some changes, as arrangements were made for accounts between native banks and modern and foreign banks to be cleared through the Bank of China and the Bank of Communications.

As a consequence, most of the reserves, which had previously been scattered among the native banks, were concentrated in these two modern banks. In fact, some native banks found it convenient to keep current accounts with modern banks, in order to avail themselves directly of the facilities of the modern clearing house for their collection from other modern banks. However, until the summer of 1935, when native banks were caught in serious difficulties, they remained depositories of banking funds and clearing reserves on balance, though their importance in this respect had greatly diminished as compared with the situation prevailing before 1932. Nonmember native banks of the native clearing guild, and modern and foreign banks in those centers where the modern clearing mechanism was not established, continued to maintain deposits with clearing native banks.[4]

No statistics on the amount of deposits of the native banks were made available, except for Hangchow (Chekiang) in 1932 and for Shanghai in 1934. In Hangchow, sixty-five banks had total deposits amounting to CN$8.2 million, which may be compared with their aggregate capital of CN$865,700. In Shanghai sixty native banks of the *Wei-wah* (clearing) group,

[4] Chang, George H., "The Practice of Shanghai Native Banks," *The Central Bank of China Bulletin,* December 1938, pp. 312-3.

with an aggregate capital of CN$17.2 million, had fixed deposits amounting to CN$36.8 million and current account deposits amounting to CN$119.6 million. The predominance of current accounts is a fair indication of the mercantile character of native banks' deposits; it should be noted, however, that they never canvassed much for long term savings. A relation of 8 or 10 to 1 between deposits and capital of the native banks may probably be taken as a fairly general measure.[5]

Chop Loans and the Native Interest Rate. Aside from capital and deposits, the native banks derived their means from "chop loans" and note issue, whose importance declined greatly in recent years. The chop loan was a typical inter-bank call loan with no security requirement; it was used not only among native banks, but also between native banks and foreign and modern banks. Chop loans were used mostly by native banks to settle debit clearing positions and to meet payments of checks and drafts drawn by other native banks, by modern banks and by customers. Native banks in Shanghai and in other Treaty ports, however, managed these loans in a way similar to that by which bill brokers of western markets manage call money from the banks, that is, in investing surplus funds of commercial banks and of foreign banks. In times of market crisis these loans were always strictly curtailed and called back, thereby causing serious difficulties to the native banks, which had the funds tied up in slow or illiquid assets and lacked rediscount facilities. Chop loans were of three kinds:

Extension chop loans, granted for a term of two days, which could be extended time after time. The arrangement for extension was made on the morning session of the market; no actual payments or receipts were effected, but the parties entered a new item of credit or debit in their account books.

Spot chop loans, generally contracted during market operations after extension chop loans had been made. Excess liquid funds were invested by the banks in these loans which were frequently used in speculative transactions.

Single-day chop loans, usually contracted in the afternoon for the settlement of clearing balances in the day's accounts. This loan was cleared on the following day.[6]

[5] *China Industrial Handbooks: Chekiang,* 1935, pp. 783, 790-1; "Native Bank Business in Shanghai," *Chinese Economic Bulletin,* May 19, 1934.

[6] Chang, George H., "The Practice of the Shanghai Native Banks," *The Central Bank of China Bulletin,* June 1939, pp. 134-5.

CN$100 million Currency Loan of 1935) to the three Government banks for advances to the native banks. To this effect, a Native Banks Supervisory Committee was established, with the purpose of assessing the value of securities against which accommodations could be granted or renewed. As collateral for loans the native banks deposited Government bonds and slow assets (real estate deeds and commodities) amounting to CN$50 million.[9]

At the beginning of 1937, when the monetary crisis finally came to an end, an unpaid balance of CN$18 million remained, which was foreclosed by mutual agreement between the Government banks and the Native Banks Clearing Association. Similar measures were taken in other places (in Kiangsi province, at Hankow, at Tientsin and elsewhere). There is no indication that the flow of chop loans was resumed to any important extent; when the Sino-Japanese hostilities began in the summer of 1937, native banks were still liquidating their slow assets and carrying on a limited business on their own resources.

Bank Notes. Another important source of funds was the issue of banknotes. Prior to the currency reform of November 1935, two kinds were placed into circulation by native banks: notes in their own name and notes obtained from modern banks.

Notes in their own name consisted of local yuan bills, subsidiary currency and copper notes; these circulated only locally. In the soundest cases, reserves were kept with the local native bankers' guild or chamber of commerce, which countersigned the notes. Payment of the notes was effected by the issuing bank at the daily clearance, along with that of other documents of debit. The most important and special case of yuan bill issue by native banks was in Foochow (Fukien). In 1932 bills were issued by forty-five institutions, of which, however, only twenty-eight were registered with the local chamber of commerce as issuing banks. The bills were based on a nominal copper standard, the Dai-fook, consisting of 1,000 copper cash (something less than one national yuan) and were in ten denominations from 1 to 200 local yuan; the average amount in circulation was estimated at about 4 million local yuan. Subsidiary currency and copper notes were issued by native banks in various cities of Shantung (Weihaiwei, Chefoo, Tsinan, Lungkow), Kiangsi (Nanchang, Kiukiang), Kiangsu (Soochow, Hsuchow, Tung-

[9] *Ibid.*, p. 73.

shan), Kwangtung (Swatow), Kwangsi, Shansi, Shensi, Chahar and Hopei (Peiping). In a few other places the custom was discontinued by the provincial-military authorities, who controlled the local modern bank of issue. Only the native banks in Chungking (Szechwan) apparently refrained voluntarily from issuing bank notes.

Note issue of the native banks was often under a nominal jurisdiction of the provincial government and it was usually placed under a de facto control of the local native bankers' guild and/or the chamber of commerce. In rare instances the notes commended confidence and were adequately secured (in Lungkow and in Foochow), but in too many cases the notes flooded the market in such quantities that they were accepted only at a discount. Owing to their low face value, these notes circulated mostly among the poorest classes of the population and their depreciation caused great distress among the people. After 1935, however, their circulation decreased under the combined pressure of provincial banks, which were eager to extend their subsidiary notes, and of the National Government, which took steps to establish a uniform national currency. The frequent bankruptcies of native banks in those years contributed to a further contraction of their circulation.

Native banks were also in a position to obtain bank notes and subsidiary currency from modern banks of issue by depositing a reserve consisting of 60 per cent in cash (silver) and 30 per cent in Government bonds or property deeds; the remaining 10 per cent of the reserve could be made in sight drafts. The native banks continued to receive the income from the security reserve and also received interest on the cash reserve. The notes bore the name of the original bank of issue and a special mark for reference, but to the general public there was no apparent distinction. This peculiar system of note issue helped to distribute the note circulation of the large banks; frequently the indirectly issued notes of a bank amounted to more than one-fourth of its total amount of outstanding notes. In November 1935 an agreement was reached between the three Government banks (the Central Bank of China, the Bank of China and the Bank of Communications) and the Shanghai Native Banks Clearing Association by which this system of indirect note issue was to be continued.[10]

[10] *North China Herald,* January 15, 1936.

USES OF FUNDS

The very informal nature of native bank activities is made even more evident by the way funds were invested and other business operations conducted. There were no limitations, legal or customary, as to the kind and extent of operations, nor were there requirements for special reserves. The bulk of funds available to the banks was invested in loans and advances, mostly to business firms and seldom to individuals.

Loans and Advances. There was no clear distinction between short- and long-term loans. Some loans had no fixed terms for repayment, some were callable by the banks at terms from three to six months and sometimes one year and others were callable at a fixed long-term date (from the third to the ninth month of the year) but repayable by the borrower on shorter terms. All loans were cleared at customary dates (usually March-April and September-October), and if the bank deemed it necessary, the debtor could be asked to settle the loan before maturity. Rates of interest charged were also matters of arrangement. Rates from 2 to 7.5 per mille per diem were fairly general for short-term loans, and rates between 8 and 17 per cent per annum were usual for long-term loans. A basic rate, upon which market interest could be calculated, was frequently fixed either by custom or by the bankers' guild at the settlement dates. Collateral securities for loans had no purpose other than insuring repayment; therefore, anything of value could be accepted as security, irrespective of its actual negotiability. Aside from bills of lading, stocks and bonds, deposits of merchandise were most frequently used, and the banks often kept their own go-downs (warehouses) or they accepted receipts from other warehouses. Real estate loans against deposit of property deeds accounted for substantial amounts in the portfolios of native banks in Shanghai, Hankow, Canton and other important cities; loans secured by land or real estate (which in China are usually equivalent to conditional sales and transfers of ownership rights) were granted less frequently. Business licenses were also accepted as security.

The overdraft was the most prevalent form of credit, however. With their limited capital, the merchants would encounter considerable difficulty in making purchases of products in

interior provinces, if they were not financed by overdrafts of the native banks. The limit of credit was usually fixed at the beginning of the Lunar new year; the security was a personal obligation although the credit might be guaranteed by a third party; terms as to the amount, length of time, etc., were agreed upon and written in a passbook, in which drafts were drawn. In normal times the facilities granted could be overstepped, although the banks maintained a right to call for repayment on short-term notice. In case of emergency, however, the native banks did not refrain from closing the use of credits, notwithstanding the written authority granted to the customer. As a rule, the rate of interest on overdrafts was fixed on the basis of the native interest rate. In Shanghai, for instance, it was based on the monthly average of the native daily rate, with a minimum of 4.5 per mille per month, plus 3 per cent per annum as commission; in Ningpo (Chekiang) it was fixed by adding 12.5 per cent to the prevailing annual native rate. Advances to other banks were made in time of need, mostly in the form of chop loans. Discount of forward bills was unusual, and, when done, the only purpose of the paper was to serve as security for a short-term loan.

When a native bank was not in a position to extend a long-term loan (usually of investment type) alone, it could invite other banks interested in the matter to form a financing group for the purpose. The contract, deeds and other documents in connection with the loan were placed in the custody of the promoting bank and the participating banks advanced funds in amounts fixed according to their respective capacity.

Loans and advances were not granted at the counter, unless the bank was very well acquainted with the borrower. Credit operations were subject to a strict investigation by the bank of the commercial and social standing of the applicant; balance sheets or similar statements were not required, as such procedure was contrary to the Chinese custom. This manner of dealing on the basis of "gentlemen's agreements," was very general and suffered only a few exceptions. In Canton the Szeyap banking group (of relatively recent establishment) required some form of tangible security against loans, but was regarded with disfavor by local merchants, and it did not gain very much in importance as compared with the older and more

conservative Shuntak group. Another example is native banking in Wusih, one of the leading industrial cities of Kiangsu.[11]

Statistics on loans granted by native banks are available only for Hangchow (Chekiang) in 1932 and for Shanghai in 1934. In Hangchow sixty-five native banks, with total capital of CN$865,700 and total deposits of CN$8.2 million, granted loans for CN$8.7 million. In Shanghai sixty *Wei-wah* banks, with aggregate capital of CN$17.2 million and deposits of CN$156.4 million (77 per cent of which was in current accounts), had total loans amounting to CN$152.9 million, of which CN$70.8 million or nearly one-half, were so-called long-term loans.[12]

Remittances and Exchange. Remittances and exchange were other important operations of native banks. Provincial and inter-provincial remittances were effected by the native banks in the form of letter, draft and telegram, through branches and correspondents in other cities. A commission was charged based on the distance of the remitting bank from the place where payment was to be made; the charge usually varied from 2.0-3.0 to 7.0-8.0 per mille. Drafts on other cities could be bought at rates quoted by the local bankers' guild. This business, however, was considerably affected by the introduction of the postal money transfer system and by the appearance of modern banks which were better equipped with branches and correspondents in other localities.

Before 1935, native banks in southern China controlled the distribution of remittances of overseas Chinese. In 1935, however, the native banks of Swatow (Kwangtung) found themselves in serious difficulties in disbursing remittances estimated at 5 million local yuan a month, owing to the drain of silver from circulation, and in Amoy (Fukien) the service was taken over by newly established modern banks.

Operations in domestic exchange were traditionally connected with internal remittances. Native banks used to establish the official rate between the local yuan and the Shanghai or Hongkong currencies. As a rule there was a very active market for Shanghai funds in central and northern China and for Hongkong currency in southern China, while in Shanghai and

[11] Chang, George H., "The Practice of the Shanghai Native Banks," *The Central Bank of China Bulletin,* December 1938, pp. 313-4.

[12] *China Industrial Handbooks: Chekiang,* 1935, pp. 783, 790-91; "Native Bank Business in Shanghai," *Chinese Economic Bulletin,* May 19, 1934.

in Hongkong the demand for funds in the interior was rather limited. Therefore, the inter-provincial remittance rate for Shanghai and Hongkong was determined in the interior by the native banks, which handled the internal trade, rather than on the coast by the modern banks. The situation underwent a change due to the expansion of the modern banks, the extension of the political control by the National Government and the wider use of a uniform currency. Between 1935 and 1937 the Government banks were able to stabilize the internal exchanges at nominal par values, with charges of 1 to 10 per mille for inter-provincial remittances. Domestic exchange became, therefore, less profitable, although native banks missed no opportunity for speculating on it.

Operations on fractional exchanges were conducted on copper coins and the so-called "small silver money." These copper and silver monies, technically subsidiary currencies, practically were separate standards whose rates of exchange with the "big money," or national yuan bank notes, usually oscillated widely. In Shanghai the rates were stabilized in 1936 at CN$83.33 (bank notes) to 100 small silver money and at CN$33.33 (bank notes) to 100 copper subsidiary money. Rates of exchange in northern China were left free, with copper coins appreciating rapidly during 1936 and 1937.[13]

Dealing in silver coins and bullion and in gold represented an important activity of the native banks, for both exchange and speculative purposes. Dealing in silver was very active from 1933 to 1935, but it was brought to a standstill by the nationalization of the metal and the stabilization of the currency in 1935. Dealing in gold was basically a speculative activity; operations covered "cash" gold bars if actual delivery was contracted for, and "fictitious" gold bars if the transaction was to be settled at a later date by either paying or receiving differences in accordance with price variations. Usually the cash bar com-

[13] In Tientsin the value of 100 copper subsidiary money rose from CN$19.72 (bank notes) in July 1936 to CN$21.90 (bank notes) in November 1936. The Central Mint of Shanghai produced new copper coins on a decimal basis, which were expected to replace the old coins; their circulation, however, remained limited to Shanghai and Nanking, although shipments were made to other provinces. In June and July 1936, the Tientsin Mint produced an unknown quantity of these decimal coins, which were not accepted by the Government banks and were retired by the provincial bank. Plans to reopen the old provincial mints and branches of the Central Shanghai Mint were then criticized by Kann, E., *Finance and Commerce,* October 14, 1936.

manded a premium over the fictitious bar, which constituted the bulk of speculative trading. Operations in the gold market were sharply reduced after the stabilization of the exchanges and the Shanghai Gold Stock Exchange ceased operations in August 14, 1937 after almost two years of inactivity and financial losses.

Security Transactions. Ordinary and speculative transactions on spot and forward delivery of bonds and shares, on the banks' own account or on account of their clients, were also important sources of revenue. The portfolio of native banks usually contained a few favored securities (in Shanghai rubber shares and in Canton Philippine gold shares) and low priced Government bonds, kept in view of the speculative fluctuations of their value and because they were traditionally used as the 40 per cent security reserve for obtaining bank notes from modern banks of issue. In Shanghai during the crisis of 1935 most of those bonds were delivered to the Joint Reserve Board and to the three Government banks as security for advances.

NEGOTIABLE INSTRUMENTS

In order to carry on their transactions, native banks issued three types of negotiable instruments, the check, the bill of exchange and the native order.

The *check* could be drawn by a client of a bank in his own name on his own account or on overdraft. Usually it bore the clause: "Payable by clearing," (a device of the native bank to gain one day interest), and the bank could refuse payment in case the drawer lacked sufficient funds. Because of these limitations, the check of native banks was a less popular credit instrument than the check of modern banks. Native bank checks were of two kinds: the cash check and the time or postdated check. The former was payable by clearing, in the afternoon, while the terms of the latter ranged from five days to one month, although ten-day checks were the most common. The holder of a check could cash it only one day after its due date. The most usual form in Shanghai was the three-section check; the first section was the regular stub to be kept by the holder as receipt, the second was the check itself, while the third was the idle stub to be left with the bank for recording the authenticity of incoming checks. Merchants in the interior, however, also used two- and four-section checks.

The *bill of exchange* had an early origin in China. It was an unconditional order in writing addressed by one person to another, signed by the person giving it, requiring a designated bank to pay, on demand or at a fixed or determinable future, a stated sum in money to order or to bearer. Bills of exchange of native banks were mostly three-section bills; the first section was left with the issuing bank for checking reference, the second section was the bill of exchange proper issued to the remitting party who mailed it to the receiving party to be collected on the due date and the third section was mailed directly by the issuing bank to the designated paying bank. Bills of exchange were of three kinds: the sight draft, the fixed draft and the after sight draft—on the last, payment was due within a given period after sight.

The *native order* was by far the most important document issued by a native bank. It may be defined as a negotiable instrument issued by a native bank at the request of its clients and representing an unconditional promise of the bank to pay. It was payable to bearer upon presentation on or after a fixed date. Usually, however, it bore the clause "This order is payable only to X Bank," which made it similar to a banker's check. The native bank orders were widely used by merchants to pay for goods; they were seldom payable at sight, generally on five to ten days after sight (as fixed by the regulations of the Shanghai Native Banks Clearing Association); and the term was customarily different for different goods.

The advantages of deferred payment were three-fold: (1) merchants had sufficient time to inspect the goods before the paper fell due; (2) the native bank was in a position to collect from the merchant (who requested the issue of the order) the necessary cash for payment before the order fell due; consequently reserve funds for native orders issued were deemed unnecessary by the native banks; (3) native orders offered the native banks the opportunity to make more profitable use of their funds, especially when the market was tight.

Being a bearer's note, the native order was subject to risk of loss, in which case the last holder furnished a letter of evidence and requested the issuing native bank to announce publicly the loss of the order and suspend its payment. The issuing bank was then requested to deposit a sum covering the native order with the local guild; if no complication whatsoever developed in the

following hundred days, payment could be made to the last known holder upon submission of a written guarantee furnished by a reliable person and accepted by the bank.[14]

Before the 'thirties, native orders circulated like cash and were accepted almost unconditionally by modern and foreign banks. Through this instrument, the native banks developed a most effective system of import financing, acting as intermediaries between the Chinese merchant and the foreign bank. Traditionally, the unpaid orders of a bankrupt native bank were given a right of priority in the final liquidation of the bank's assets, and it was also expected that the native guild would assume responsibility for payment. This custom, however, never materialized in regulations, and in 1924 the Shanghai Native Banks Clearing Association refused to assume liability in the case of the bankruptcy of the Yu Feng Bank. In 1930, when the Yueh Dah Bank failed, the Association explicitly decided that, on the basis of Article 22 (g) of its Business Regulations, "the bank orders issued by the Yueh Dah Bank and unpaid till now will be treated as common debt and be paid off at the same ratio of such debts."[15] An even more serious blow came with the regulation issued by the Association in February, 1932, placing and enforcing a temporary restriction upon the circulation of the orders outside of native banks, in order to protect their cash reserves.[16] In 1935 warnings were consequently issued by foreign chambers of commerce against the free acceptance of native orders.[17] In a mild defense, the manager of the Clearing House of the Shanghai Bankers Association observed that after the new Civil Code and the Law on Negotiable Instruments were introduced in 1929, the liquidation of the native banks was placed in the hands of legally appointed

[14] Arnold, J., *China, A Commercial and Industrial Handbook,* Washington, 1926, pp. 179-83; Chang, George H., *loc. cit.,* pp. 315-9.

[15] The Association denied any common guarantee or any collective liability for the native orders, since its committee had no authority of examining periodically the situation of the members. See *North China Daily News,* May 20, 22 and 29, September 10, 16, 1930 (Yueh Dah case and Mitsui Bussan Kaisha against Doong Sen Bank).

[16] The regulation makes reference to the fact that similar restrictions were placed (but not enforced) upon the circulation of the native orders in 1901 and in 1911, when a situation of emergency arose in the market. *North China Daily News,* February 29, 1932 and letter by E. Kann to the *North China Daily News,* February 26, 1932.

[17] Such warnings appeared in the *British Chamber of Commerce Journal,* July 1935, and in the *North China Herald,* November 21, 1935.

accountants and no rights of priority were, therefore, recognized.[18] The complete confidence of the public in the native orders was somewhat shaken, however, and endorsement by the payee was thereafter frequently required by modern banks.

No reliable statistical analysis of the native orders issued by native banks has ever been made. According to a conservative estimate made in 1938, the yearly pre-war average of the number of native orders issued by each Wei-wah native bank of Shanghai was placed at around 10,000, while the yearly average face value of the native orders of each native bank was estimated at no less than CN$30 million.[19]

SETTLEMENT OF DEBITS AND CREDITS

Before there were any Chinese modern banks in Shanghai, the native banks already had an organization similar to a modern clearing house, the Native Banks Clearing Association, which was established in 1890. The members of the association were known as the *Wei-wah,* or clearing native banks, among which checks and drafts were circulated and were received and paid by means of transfer of accounts.

The procedure of settlement among native banks never changed substantially. Before 2 p.m. each native bank sent a "clearing certificate" to the other banks concerned, indicating the amount of credit or debit obligations to be settled; this paper served as a preliminary notice. After July 1936, two classes of clearing certificates were used, class A for amounts exceeding CN$500 and class B for amounts below that figure.

After 2 p.m. each bank issued a "treasury note" for the amount of its debit obligation toward other banks; all treasury notes were gathered at the Clearing Association after 4 p.m. The final part used to take place at 6 p.m., in the quarters of the Association. Balances resulting from offsetting debits and credits represented by the treasury notes, were paid in cash or settled through call loans, granted either by each creditor bank to each debtor bank (if this was mutually agreed upon), or by third banks. Before July 1936, balances of less than CN$500 were not included in the treasury notes, but were entered in the books of the creditor bank and paid on the following day

[18] Chu, Percy, "Risk of Bank Orders Not So Big," *North China Daily News,* July 27, 1935.

[19] Chang, George H., *loc. cit.,* p. 316.

with other items. Against the possible loss of these odd balances due to creditor banks, each clearing bank was required by the Association to deposit a guarantee fund of CN$30,000. Beginning in July 1936, however, cash settlement of any amount in daily clearance was required and the guarantee fund was repaid.

Before 1933, balances between modern and native banks were settled through the Native Banks Clearing Association. As a result, the modern banks had to place deposits with a native bank, which acted as their agent through which clearing balances were handled. In 1933 the Clearing House of the Shanghai Bankers Association opened for operations in Shanghai, and this was shortly afterward followed by similar institutions in Hangchow, Tientsin and Nanking. Thus many native banks found it convenient to open a current account with a modern clearing bank and to use it in collecting directly from other modern banks.

The regular procedure, however, was somewhat different. The modern member banks collected items through their clearing house. The banks sent all the native orders and checks they received to the clearing house, which in turn sent them to the native banks in batches, according to the respective payee concerned. The latter, upon receipt of such items, issued clearing slips drawn upon the Joint Reserve Board of the Native Banks Clearing Association. These clearing slips were collected at the Clearing House and represented the total claims of the modern banks against the native banks. On the other hand, the native banks, while still retaining the practice of sending their credit items directly to the modern banks, received in return special checks drawn upon the Joint Reserve Board of the Shanghai Bankers Association. The special checks so received by the native banks were deposited with the Joint Reserve Board of the Native Banks Clearing Association and represented the total claims of the native banks against the modern banks. Toward the closing hours of business the claims as represented by the clearing slips received by the Joint Reserve Board of the Shanghai Bankers Association and the special checks received by the Joint Reserve Board of the Native Banks Clearing Association were offset against each other; the balance went to increase or decrease the deposits kept by the Bank of China and the Bank of Communications with the Joint Reserve Board of the Native Banks Clearing Association.

For collection of items due from the foreign banks, native banks sent their items to each foreign bank through the Joint Reserve Board of the Native Banks Clearing Association. The Board received in return a cashier's order of the foreign bank, drawn upon a modern bank, which was paid as mentioned above. Foreign banks, on the other hand, collected directly from each native bank, which issued checks drawn upon a modern bank, to be cashed at the Bank of China.[20]

CO-OPERATION AMONG NATIVE BANKS

Native banks combined in local guilds and associations for the purpose of developing a co-operative policy in matters of common interest. Banks were admitted to the guilds with different functions and privileges, according to their size and their resources. The Shanghai Native Bankers Association, organized in 1920, required a minimum capital of CN$20,000. Smaller institutions, which numbered about seventy in 1934, organized separate guilds, called *Nantao* and *Chapei* from the sections of the Chinese city where they were located. In Ningpo, which boasted the oldest bankers' guild of China (said to be more than a thousand years old), the capital requirement was CN$60,000. The member banks were generally divided into classes, and *likins,* fees, and fines were levied on the basis of the size of their capital and reserves, or of their business. Admission to the guild was by ballot, and a chairman and a committee were elected at the annual general meeting convened at the new year.

Among the chief functions of a guild was the settlement of balances between member banks, the determination of the daily native interest rate and of the domestic exchange rates and the liquidation of the member banks (both by voluntary choice and by bankruptcy). Although no definite rule existed, in cases of difficulties the guild often gave assistance to members if they could show sufficient slow (i.e., non-readily cashable) assets. There was practically no limitation regarding the activities of a guild: it determined the rules for the apprentices, for fair practices among member banks, for assaying bullion, etc. It fixed the basic rates for deposits and advances, and it prohibited

[20] Chu, Percy, "Development of the Clearing System of the Chinese Modern and Native Banks in Shanghai," *The Central Bank of China Bulletin,* March 1940, pp. 16-20.

operations considered contrary to the interest of the craft. Moreover, it acted as a judicial court for the members, to which any complaint had to be referred in the first instance. The penalties for violations of such rules were fines, public reprimand, suspension, expulsion or boycott.

With the development of the modern banking system and the decline of native banks, the guilds lost much of their authority. In Shanghai the Native Banks Clearing Association and the Native Bankers Association took over many of the functions of the older guilds. However, the transfer of the liquidations of closed banks to legal accountants and the appeal by the native banks to the Government for funds (which resulted in the appointment of a Native Banks Supervisory Committee in charge of examination of the balance sheets of the banks) marked a most serious departure from the old custom of self regulation. In Canton the old Chung Hsin Tung, which was established before 1675, let its authority be transferred to a bankers' association, formed in 1923 and reorganized in 1931. Its members included native banks of all types, a few modern banks and some individual money dealers.

CONCLUSION: THE CRISIS IN NATIVE BANKING

In 1937, when the Sino-Japanese hostilities began, native banking was in a most serious plight, and in the Treaty ports it appeared in a state of collapse. Undoubtedly, native bank resources were inadequate, and their personal manner of dealing did not fit into the progressive modernization of the country. Speculative operations, the chief source of irregular profits, were curtailed by the economic crisis and by the extension of political control over the country. Land values had declined sharply, internal exchanges had lost their old attractiveness, silver had disappeared from circulation and gold dealing had become barely profitable. At the same time, bank notes were progressively nationalized, remittances were transferred to modern institutions and the establishment of modern clearing houses altered the system of inter-bank relationship. The native banks failed to keep pace with the changes of the country. Moreover, they also failed to keep faith with their best traditions, when their guilds refused to uphold the most important paper of the members, the native order, and made appeal to a law of the Government in order to sanction the break in the

customs of the guild. Native banks always were, if not outside, certainly aloof from the law, and their credit was maintained by a long tradition of gentlemen's agreements, sanctioned only by mutual confidence.

The immediate cause of their sharp decline from 1935 to 1937 was, however, the deflationary situation created by the rise in the price of silver, following the silver purchase policy adopted by the United States in 1933. This brought about an increase in interest rates, a freezing of funds and difficulties in the collection of advances and loans. The deflationary situation was anticipated in the interior by at least two years, owing to the steady outflow of silver to the Treaty ports accompanied by the fall in agricultural prices and political and military disturbances.[21] During 1933 and 1934 the official net shipments of silver from the interior to Shanghai amounted to CN$238.9 million. Measures to stop this outflow were introduced by the provincial governments. Kwangtung and Kiangsi, the two southern provinces financially dependent upon Hongkong, promulgated various measures in 1931, 1932 and 1933. At the beginning of 1934, Hunan prohibited the shipments of silver in excess of CN$500 and levied an export tax; despite this, the financial stringency continued and the provincial bank was forced to withdraw silver from Hankow in order to make advances to the local native banks. Restrictions on the export of silver were introduced by the Kansu and Shensi governments. Silver and banknotes, amounting to about CN$34 million, were shipped by the Government banks from Shanghai to Hankow between the second half of 1934 and the first half of 1935.

Native banks in Hankow were fairly representative of native money markets in the interior, since they acted as financial agents for local banks of the central and western provinces in liaison with the modern institutions of the city. These banks had been steadily deteriorating since their mass bankruptcy in 1928, during the short-lived Nationalist-Communist Government. Most banks reopened for business in 1929 without settling their past liabilities, and as a result, they lost prestige in the market. They went through new crises in 1933, when

[21] The Committee for the Study of Silver Values and Commodities Prices, appointed by the Ministry of Industry in 1934, emphasized particularly the fall of the agricultural prices as the cause of the silver movements. *Silver and Prices in China,* Shanghai, 1935, pp. 58-59, *passim.*

fifty-eight of them failed, and in 1935, when one third of the remaining seventy banks suspended operations. The surviving native banks limited themselves to ordinary operations on overdue accounts and became most cautious in granting new credits and even in renewing old credits to customers.

At the new year's settlement of 1934 some native banks in Tientsin were forced to close. During the course of the year the stock of silver in the city declined from CN$105.2 million to CN$43.6 million, the financial market becoming increasingly stringent. The collection of outstanding credits proved to be extremely difficult and some twenty-five other native banks closed late in 1934. A more conservative attitude on the part of the remaining banks permitted them to weather the new year's settlement of 1935 satisfactorily, but in the following June a panic caused two more native banks to fail. Some bankruptcies also occurred in Peiping at the same time. During 1936 the business of native banks in northern China was further curtailed by the lack of "legitimate trade," since the overflowing "special trade" (smuggling) from the Japanese-controlled area of "East Hopei" was financed directly by Japanese banks.

The situation in Shanghai remained satisfactory until late in 1934, owing largely to the liquid funds accumulated in the market. The stock of silver in the city increased from CN$266.2 million at the end of 1931 to CN$562.8 million in the middle of 1934. The Shanghai modern banks, without fully utilizing their power of expansion, increased the note issue in circulation from CN$245.4 million to CN$359 million. The monetary base (silver and notes) of the market had thus been expanded in two and a half years by CN$410.2 million, and the problem for the banks was to find profitable investments for their funds in a period of business depression.

This situation was reversed in the summer of 1934 by the drain of silver abroad and by the shipments of funds by the Government banks to other centers (Hankow, Tsingtao, Tientsin, Foochow, Amoy, etc.), where the monetary stocks had previously been depleted. Thus the silver stocks in Shanghai declined to CN$335 million in December 1934, and although the bank note issue had been further increased by about CN$60 million, a portion of it was shipped to the interior and the rest was not sufficient to neutralize the increased hoarding of silver coins. With the new year's settlement of 1935 four *Wei-wah*

native banks failed and ten or more were obliged to reorganize. In June 1935 some thirteen native banks were in liquidation, and two more small institutions failed in the subsequent September. At the end of 1935 CN$45 million of native inter-bank accounts was outstanding and the various credits granted by the modern banks to the native banks during the year were almost entirely overdue. Twenty other native banks went into bankruptcy before the new year of 1937, although the settlement passed without serious repercussion.

Most of the operations of the native banks in Shanghai in 1937 were related to the liquidation of their slow assets. New credits meanwhile were restricted. The decline in business is evident from their clearings; the sharp decline in 1936, during a period of rapidly rising prices, and the uninterrupted fall in relation to the clearings of the modern banks, were unmistakable signs of a definite contraction of the sphere of the native banks.

TABLE 3

MONTHLY AVERAGE OF NATIVE BANK CLEARINGS IN SHANGHAI
1932–1936

	Amount (in thousands of national yuan)	*Ratio of the native bank clearings to total Shanghai bank clearings*
1932	1,976	100
1933	1,698	92
1934	1,902	87
1935	1,732	85
1936	1,386	75

Source: The Central Bank of China Bulletin.

A similar situation prevailed in other markets. Fifteen native banks failed in Ningpo (Chekiang) between January 1934 and June 1935, and in August 1935 about one third of the surviving sixty banks closed their doors. Several native banks went on the rocks at about the same time in Wusih, the industrial center of Kiangsu, and in Foochow and Amoy, the two flourishing cities of Fukien. In Canton in 1935 a few surviving institutions restricted themselves to carrying outstanding credits. The total number of bankruptcies during 1935 among the native banks of thirty-one cities was estimated at 148; business depression, tying-up of capital, defaulted loans and adverse effects from other failures were indicated as the general reasons.[22] The

[22] Chang, F. Y., "Banking and Currency," *The Chinese Yearbook*, 1936-1937, p. 808.

situation of the native banks would have been even more serious if the Government banks and the National Government had not lent support. After the currency reform of November 1935 the strain was somewhat relieved and no other major casualty occurred. But, on the other hand, there was no indication of recovery, or of thorough reorganization; internal reorganization into modern institutions was seriously hampered by the lack of capital. The struggle for liquidity remained the chief concern of the native banks.

OTHER NATIVE FINANCIAL INSTITUTIONS

All other institutions of the native money market were dependent in various degrees upon the native banks. It is often impossible to differentiate between banks and other institutions with exchange and credit as their business, since there was a large neutral zone, to which small native banks and better capitalized cash shops and pawnshops belonged.

Cash Shops. Cash shops may be defined as the least developed type of native banks. Their chief business was domestic exchange, on which they charged a commission of 1 per cent; they participated actively in speculative dealings and did not entirely neglect foreign currency. Moreover, cash shops issued copper notes in all places and at all times the public was willing to take them, notwithstanding official prohibitions. They financed small local traders and street vendors with loans ranging from a few yuan to several hundred yuan, frequently advanced and repaid on a daily basis. They often kept deposits for clients and friends, on which they paid an interest rate lower than native banks. They had practically no internal organization, and the manager was the proprietor himself, with few employees, most of whom were apprentices. Consequently, running expenses were very low. Their capital ranged from a few hundred to a few thousand national or local yuan; in case of need they turned to a native bank with which they kept an account. They were often organized into a guild, and in a few cases they belonged to the same guild as the native banks. The number of such shops changed very rapidly with developments in the local situation. In Nanking, for instance, there was a mushroom growth between 1928 and 1931, but almost all failed during the latter part of 1935.

Pawnshops. Pawnshops played a very important part in the

economic life of the masses and especially of the farmers, and were to be found in almost every part of the country, even in the smallest towns and villages. The pawnshop was a private enterprise owned by a single proprietor, by a native bank or by partners; corporative, municipal and nonprofit enterprises were extremely rare. Chains of pawnshops, controlled by wealthy families, were not unknown. In Fukien a number of pawnshops was traditionally conducted by Chinese from Formosa and Koreans, registered with the Japanese consulates. The financial standing of a pawnshop varied widely from a few hundred national or local yuan to CN$100,000 or more in the case of five Shanghai firms; current funds were normally supplied by native banks and occasionally by modern banks. In 1937 there were in Shanghai approximately 100 large pawnshops and 400 small pawnshops, with an average capital of approximately CN$4,000. Half of the large pawnshops and one tenth of the small pawnshops were situated in the Chinese City, while the rest were in the International Settlement and the French Concession.[23]

Pawnshops were classified into four categories, namely: (1) *Tien*, (2) *Tang*, (3) *Chih* and (4) *Ya*. The *Tien* had the largest amount of capital, offered the longest period of redemption, charged the lowest interest rate and gave the highest estimate on the value of goods. The other categories, *Tang*, *Chih* and *Ya*, followed in order. As time went on, however, no sharp line of demarcation could be drawn. In Shanghai the four kinds of pawnshops were grouped under the City's Regulations (promulgated on February 7, 1930) into two classes; i.e., the large pawnshops (*Tien* and *Tang*), with capital of CN$30,000 or more, and the small pawnshops (*Chih* and *Ya*), with capital less than CN$30,000.

Pawnshops of the various categories were organized into a guild which had powers over its members similar to those of the native bankers' guild, but could also determine the site for the establishment of new pawnshops, in order to eliminate cut-throat competition. The guilds charged registration fees, capital, transactions and loan taxes. Pawnshops were therefore apt to give lower figures for the amount of their capital, as a means of evading fiscal charges.

A *Tien-Tang* pawnshop was internally organized into four

[23] Chow, Chi-pong, "Pawnshops in Shanghai," *The Central Bank of China Bulletin*, September 1938, pp. 185-203.

departments, to take charge of business transactions, cash and treasure, safe-keeping and accounting, respectively. A pawnshop was directed by a manager assisted by a staff of employees and servants ranked on a very strict grading system. Employees, as a rule, were provided with free board as part of their remuneration and received a very low cash salary, but they were permitted to collect a special storage due of not more than 2 per cent per month, while sharing in the various fees charged in loans, service charges, brokerage, duplication of the pawn-ticket, extension of the term, tea money, etc.; moreover, they received a bonus from the profits.

Articles accepted as pledges were classified under two main categories; i.e., wearing apparel and jewels, and agricultural products. There was no uniform rule for the appraisal, and loans were granted on a basis of 20 to 60 per cent of the appraised value. Time limits for redemption ranged from four to eighteen months, and terms of grace were strictly limited to five or ten days. Extension of the loan could be obtained, however, provided interest and other special charges were prepaid. Disposal of the unredeemed pledges was made every month in the small pawnshops and once or twice a year in the large pawnshops, usually by auction. Members of the staff had a priority to purchase the goods to be disposed of and to share in the net proceeds of the total sales. The disposal could be effected through a store owned by the pawnshop, or by advance sale to some retail merchant of every unredeemed article remaining at the end of each month; the retailer usually paid off loans, interest, charges and dues. In Ningpo (Chekiang) the unredeemed pledges were taken over by a buyers' guild once a year.

Although there was a maximum annual interest rate legally fixed at 20 per cent, the de facto rates averaged between 1.6 and 6 per cent per month, with payments made monthly, weekly and daily. In the lower pawnshops and for small amounts the total payments rose to as much as 10 or 20 per cent a month. Prepayment of the interest was a practice used only in Chekiang. Some pawnshops received deposits, on which they paid an interest rate lower than that paid by native banks (Ningpo, in Chekiang), and they granted loans on promissory notes, signed by a guarantor (Wuhsien, in Kiangsu).

Hwei. Well-to-do farmers and merchants in need of funds (usually for social purposes and ceremonial rites) obtained loans

through the *hwei*. The *hwei* may be defined as a "loan club" or "loan association" formed to help a member of the local community through small periodical contributions of the members. Such a primitive form of co-operation is very common in the Orient and is known in Japan by the name of *mujin*. Generally, the *hwei* was a temporary or emergency organization; however, in southern China the *hweis* acquired land properties with funds made up of membership fees and contributions and developed into powerful organizations or clans of merchants and landlords.[24] The usual handling of a loan was simple enough, although details were different from one case to the other. Each member of the *hwei* paid an equal amount of money at stipulated intervals and the lump sum thus collected went first to the promoter and then to the other members, in accordance with a pre-established order, or by lot drawing, or by auction. The *hwei* was usually formed by the person in need of funds, who was the first to obtain the money, but in exchange entertained the other members at any date at which contributions were to be made. It is clear that this money was not a loan in a strict sense; it represented the principal resulting from the contributions of each member. The *hwei* could be dissolved when each member had received the amount due to him; the term for this varied from a few months to ten years or more. Interest rates, when charged, ranged from 3 or 4 per cent a year to 1.5 or 2.5 per cent a month. The administration of a *hwei* was entrusted to one of the members in the old Chinese tradition of a gentlemen's relationship, with no formal control or auditing on the part of the other participants.[25]

Last, but not least, was the *individual money lender*. His importance cannot be overemphasized. He usually belonged to the class of merchants, retired officials and landlords, and made advances in goods (rice, grain and other foodstuffs) and cash (on the security of future crops or land). Credit sales of seeds against advance purchase of the produce were also very common. The credit terms ranged from eight months to one year in the case of loans on crops and were two or more years in the case of loans secured by land. Interest on short-term loans was

[24] Chen, Han-seng, *Agrarian Problems in Southernmost China,* Shanghai, 1936, p. 25.

[25] Chow, Chi-pong, "Value of Loan Societies to China," in *The Central Bank of China Monthly,* August 1936; Nan, Ping-fong, *A Practical Study of Rural Credit in Four Provinces of Central China,* Nanking, 1936, *passim.*

paid in advance and no allowance was made for anticipated repayment; moreover, rights of priority were granted for purchase of the crops, different methods were used for the valuation of the goods, different prices were charged and paid and the inevitable fees and gifts were added. Therefore, it was practically impossible to evaluate the rate of interest in the cost paid by the borrower.

Long-term loans were secured by land and assumed two different forms. The first was the *Tien tang* or *Tien mai,* in which possession of the land itself was transferred to the creditor for a limited number of years or in the form of a conditional sale; this implied that the debtor had the right to regain possession of the land by repaying the debt or by paying back the original price. The utilization of the land by the creditor was intended to substitute for payment of interest; however, it was common enough for the mortgagor to retain the right to till the soil against payment of an annual rent. The second form was the *Ti ya,* a real mortgage in the sense that we give to this word. Owing to the lack of a system of land books, the guarantee was given by passing the title or deed of property from the debtor to the creditor. Mortgage loans were granted up to 50 or 60 per cent of the market value of the land, but seldom above; interest or rent ranged from 20 per cent of the amount of the loan, if paid in cash, to one third of the net annual produce, if paid in kind. It is evident that the *Tien tang* and *Tien mai* (which were the most diffused forms of long-term loans) did not answer the economic needs of long-term agricultural credit. They did not give the farmer the means with which to open new land for cultivation, nor to improve his farm; on the contrary, they deprived the owner-farmer of the possession and ownership of his land and reduced him to the state of tenant. As a consequence, loss of land through debt was regarded as a great disgrace, and the typical Chinese farmer used to hold on to the land even after the last quilt had gone to the pawnbroker and the daughters of the family had gone out as slave-girls.

CHAPTER VI

THE FOREIGN MONEY MARKET

THE FOREIGN BANKS

The foreign money market may be defined as the market formed by those institutions and organizations handling monetary and financial business in China under foreign control. At the beginning of the Sino-Japanese war, foreign institutions were legally restricted to the Treaty ports (i.e., those cities opened to international trade by China on the basis of treaties or by voluntary action) and were prohibited from maintaining branches in the interior of the country. Laws and regulations of the Chinese authorities were not applicable in the case of British, American, Japanese, French, Belgian, Dutch and Italian banks, which, owing to the special rights of extraterritoriality, were legally subject to their own national laws; the enforcement of Chinese laws and regulations with regard to the few foreign banks without extraterritorial rights (German, Russian, and Sino-foreign banks registered under Chinese laws) was entrusted to the Chinese Special District Courts operating in the foreign-controlled areas by agreement between China and the Treaty powers.

Shanghai was by far the outstanding financial center of China; minor centers were represented by Tientsin in northern and Hankow in central China. Hongkong was the leading market of southern China, although it was not territorially part of China; the small island of Shameen, the Anglo-French concession at Canton, was an appendage to Hongkong. Foreign institutions operated in a few other cities—in Peiping, as relics of the city's past political importance; in Chefoo and Tsingtao, two military and commercial ports of Shantung; in Foochow and Amoy (Fukien) and in Swatow (Kwangtung), owing to the large inflow of remittances; and in Mengtsz and Kunming (Yunnan), on the highway and railway routes between French Indo-China and China. Attempts made by foreign banks to extend their activities to Chungking (Szechwan) were only temporarily successful.

With few exceptions, practically all foreign institutions transacted general rather than specialized banking business. An elementary classification of the institutions in existence as of June 1937 can be made on the basis of nationality. The British banks led the market, with the old Mercantile Bank of India and the Chartered Bank of India, Australia and China and the powerful Hongkong and Shanghai Banking Corporation. During the 'thirties some British business firms in the Far East started banking activities (E. D. Sassoon Banking Company, Ltd. in 1930, and Finance Banking Corporation in 1932), and other foreign banks opened branches in Shanghai, including the P. & O. Banking Corporation, connected with shipping interests, and the Moscow Narodny Bank, an institution established in London in 1919 by Russian merchants and acting later on as the financial link for Soviet banks and foreign trade organizations.

The American group suffered a serious loss with the bankruptcy of the American-Oriental Banking Corporation in 1935.[1] In 1927 the National City Bank of New York reorganized the affiliated International Banking Corporation into direct branches, and in 1931 the Equitable Eastern Banking Corporation merged with the Chase Bank, a subsidiary of the Chase National Bank of the City of New York. A few local banks were incorporated under American laws, such as the Thrift and Investment Finance and Trust Corporation (founded in 1927, closed in 1935), the Underwriters Savings Bank for the Far East (founded in Shanghai in 1930), the Tientsin Commercial and Credit Corporation (founded in 1932) and the Pacific Banking Corporation (founded in Shanghai in 1934 and reorganized in 1935). White Russian interests were prominent in all these banks. The American Express Company, Inc., also transacted banking business in its branches.

The Far Eastern Bank, the financial agency of the U.S.S.R., withdrew from the Chinese market in 1935, following the sale of the Chinese Eastern Railway to the Government of Man-

[1] The American-Oriental Banking Corporation closed its doors at the end of May 1935, together with the other institutions of the Raven group (Raven Trust Co., American-Oriental Finance Corporation, Asia Realty Co.). This group was heavily involved in real estate; deposit liabilities of the American Oriental Banking Corporation at the end of 1934 amounted to CN$8.4 million. *Finance and Commerce,* May 29, June 12, 19, July 3, 24, September 4, 1935; November 11, 1936.

chukuo. In the Japanese group, after the closing of the Exchange Bank of China in 1928,[2] eleven institutions continued to operate in China; namely, three official banks—the Yokohama Specie Bank, the Bank of Chosen and the Bank of Taiwan; three "big" private banks—the Mitsui, Mitsubishi and Sumitomo Banks; four local banks of Shanghai, Hankow, Tsinan and Tientsin, and the Seiryu Bank (a Sino-Japanese subsidiary of the Yasuda interests).

The French group consisted of the Banque de l'Indochine, the Union Mobilière (a local institution with interests in Shanghai and Tientsin), and the Banque Franco-Chinoise (a joint Sino-French enterprise, heir of the Banque Industrielle de Chine). A special savings institution, the International Savings Society, was also under French law and management. French and Belgian interests were combined in the Crédit Foncier pour l'Extrème Orient. In 1935 the Banque Belge l'Etranger reorganized its branches in the Far East into a subsidiary institution, the Banque Belge pour l'Etranger, Extrème Orient. Branches in China were maintained by the Dutch Nederlandsche Handel-Maatschappij and Nederlandsch Indische Handelsbank. Germany was represented by the Deutsch-Asiatische Bank, and Italy by the Banca Italiana per la Cina. The Banco National Ultramarino of Lisbon maintained a branch in the Portuguese colony of Macao.

Foreign banks were established either as branches and subsidiaries of large foreign institutions, or they were formed by business interests residing in China. Direct branches were maintained by institutions which had their chief interests outside China (the National City Bank of New York, the Yokohama Specie Bank, the Mitsui, Mitsubishi, Sumitomo Banks and the Nederlandsche Handel-Maatschappij); by those institutions having special spheres of interests (Chartered Bank of India, Australia and China, the Mercantile Bank of India, the Banque de l'Indochine, the Bank of Chosen, the Bank of Taiwan and the Nederlandsch Indische Handelsbank), and by institutions with special connections and interests (the P. & O. Banking Corporation in shipping and the Moscow Narodny Bank, serving as the Russian merchants' bank).

[2] This bank fully paid the Shanghai deposits, but left unpaid the Peiping and Tientsin note issues. The Japanese Government refused to help the bank, and the Bank of China undertook its liquidation.

Subsidiaries or affiliates were set up by those foreign institutions unwilling to take more than a limited interest in the Chinese market. The offices of the Chase Bank were branches of an affiliate of the Chase National Bank of the City of New York, and the offices of the American Express Company, Inc. were branches of an affiliate of the American Express Company, which was in turn controlled by the Chase National Bank of the City of New York. After 1927 the P. & O. Banking Corporation was brought under the control of the Chartered Bank of Australia, India and China. The Deutsch-Asiatische Bank, the Banca Italiana per la Cina, the Banque Belge pour l'Etranger, Extrême Orient, the Seiryu Bank and the Banque Franco-Chinoise were subsidiaries of banks or groups of banks situated in foreign countries.

Foreign banks established by local interests residing in China originated either from commercial, shipping, industrial and political interests for the purpose of acting as their financial agents, or from individuals as financial speculative ventures. The latter type of banking was quite common during the land boom of Shanghai in the early 'thirties and the American-Oriental Banking Corporation was the outstanding case. A special development among certain communities took place around 1930, with the establishment of American-registered banks controlled by White Russians (the Underwriters Savings Bank and the Tientsin Commercial and Credit Corporation) and of Japanese city banks (the Banks of Shanghai, Hankow, Tsinan and Tientsin). The E. D. Sasson Banking Co. was set up as the agency of a most powerful financial family of Shanghai.

Ranking above all, however, was the Hongkong and Shanghai Banking Corporation. This bank was formed by the largest shipping, trading and engineering interests of Hongkong, and in its seventy years of life it developed a policy of close ties with the Chinese market, which could be accomplished only through a board of directors on the scene and with the backing of British diplomacy. With its branches all over the Far East and in the most important markets of the world, the Hongkong and Shanghai Banking Corporation became the most powerful banking organization of foreign interests in China—a rather exceptional situation, since no other locally established bank ever developed more than a limited business within the Chinese market.

THE COMPRADORE

The most characteristic element of the internal organization of a foreign bank in China was the compradore. He was the responsible representative and intermediary of the bank in transactions with the Chinese customers and correspondents, who derived his original *raison d'être* from the restrictions imposed upon foreign banks outside Treaty ports. He was usually a wealthy Chinese, with good social standing and large business connections, who was willing to take on his own responsibility the handling of a foreign bank's operations with Chinese clients under certain terms as fixed in a written agreement with the bank. The functions of a compradore were various: introducing new clients to the bank; collecting deposits; negotiating loans; buying drafts and orders from native banks and in the market; buying and selling coins and bank notes; countersigning loans, contracts or promissory notes with and of Chinese firms; issuing checks in his own name on Chinese banks for account of the foreign bank. For all these operations he received brokerage fees ranging from 1/2 of 1 per cent to 1 1/8 per cent; on other special transactions the commission was fixed before the end-of-year settlement.

The compradore was required to guarantee all the transactions made through his office, and also (until November 1935) the silver stock held by the bank. A cash deposit with the bank was required; until 1932, however, land deeds, bonds and other securities were accepted. The amount of this deposit was CN$100,000 or more, on which interest of 5 or 6 per cent (a rate slightly above that paid on fixed deposits) was allowed by the bank. This deposit was not withdrawable except after the final settlement of all claims arising from the agreement.

It is evident that the size of the transactions guaranteed by the compradore ran many times larger than his deposit. Therefore, although the amount of defaults was not exactly commensurate with the amount of the transactions, the foreign manager nevertheless was required to take special precautions in dealing with Chinese customers, in addition to the guarantee of the compradore.

In order to perform his functions, the compradore maintained a semi-autonomous bank department for which he received a small allowance of around CN$500 or more a month,

out of which he paid his staff. The compradore's department was formed: (a) by a group of internal employees, such as an assistant compradore, a cashier, who kept the keys of the bank's vaults jointly with the foreign cashier, some bookkeepers and, until 1935, a silver expert, and (b) by some external employees, such as the market reporters, to give references on customers and transactions, and some money collectors, in charge of collection and delivery of money and documents outside the bank. Some minor employees, called shroffs, engaged in examining and changing coins; they also performed other small functions. Employees could not be hired or discharged without the consent of the foreign manager, but they were responsible only to the compradore, who in turn was responsible to the bank for losses suffered through any of their acts. The autonomy of the compradore's department was more marked in northern China, where he used to run a banking business of his own, often not exactly distinguishable from the business made for the account and in the name of the foreign bank.

The importance of the compradore declined during the 'thirties, since many of the reasons for his existence were gradually disappearing. The growth of Chinese modern enterprises made possible direct contacts between foreign banks and Chinese clients, while the progressive unification of the country and the nationalization of silver restricted the amount of legal and financial risk involved in banking and exchange transactions. The obstacle of the language was lessened by the development of the knowledge of Mandarin Chinese among foreign employees, and by use of the English language in modern Chinese enterprises. Specified limitations were introduced on the liability of the compradore to a certain percentage of the amount of each transaction, and in southern China his role in foreign trading firms was progressively transferred to independent brokers, although no such development appeared common among banks.

With the collapse of the native banks, which performed in part the role of money brokers, the foreign banks were obliged to depend upon themselves for the investment of surplus funds, and this fact contributed considerably toward placing the compradore in a position of credit adviser rather than in that of a responsible representative of the bank. Moreover, during the 'thirties, a trend was apparent toward centralizing the authority under the control of the foreign manager, and toward limiting

the duties of the compradore to the supervision of the counter transactions performed through the Chinese staff.

RESOURCES OF THE FOREIGN BANKS

The secrecy with which foreign banks treated their operations makes it impossible to analyze statistically their resources and transactions. Foreign banks with head offices outside China refrained from issuing separate statements for their Chinese branches. The statements published by subsidiaries of foreign institutions could easily be misleading, since these banks were backed by resources and connected with a range of operations far larger than that indicated. Banks with their head office and main interests in China could give a fair indication of the resources, had their importance not been limited—with the exception, of course, of the Hongkong and Shanghai Banking Corporation. A description of the resources and operations of the foreign banks can be attempted only in an indirect way, i.e., by examining the changes occurring in the sources of banking funds and by following the external operations of the banks. The main items of the statement of foreign banks with principal interests in the Chinese market have been tabulated, however, with special regard to the period immediately preceding the opening of Sino-Japanese hostilities.

Capital. It appears that there was a great variety in the proportion between capital and reserves, and between total capital funds and earning assets. The Hongkong and Shanghai Banking Corporation accumulated assets totaling about Hk$1,000 million over a paid-up capital of only Hk$20 million and a reserve of Hk$100 million (of which about Hk$90 million was maintained in sterling). A similar proportion between capital funds and assets (of approximately 1:10) may be observed in the E. D. Sassoon Banking Company, and was probably fairly general in the case of other British and American banks. European institutions had capital funds ranging from one seventh (Deutsch-Asiatische Bank) to four fifths (Crédit Foncier d'Extrême Orient) of their total assets, and Japanese banks showed an average ratio of 1:7. Branches of banks with their main activities outside of China worked chiefly on the basis of their own local resources, with no special appropriation of funds from the head office.

TABLE 4

FOREIGN BANKS IN CHINA AT THE END OF 1936

Name of institution	*Nationality*	*Head office*	*Date of establishment in China*	*Offices in China*	*Official unit of account*	*Paid-up capital*	*Reserves*	*Deposits*	*Total assets*
Mercantile Bank of India	British	London	1854	Shanghai, Hongkong	British Pound	..	..	..	..
Chartered Bank of India, Australia and China	British	London	1857	Canton, Hankow, Peiping, Shanghai, Tientsin, Tsingtao, Hongkong	British Pound	..	..	..	..
Hongkong and Shanghai Banking Corporation	British	Hongkong	1864	Amoy, Canton, Chefoo, Foochow, Hankow, Peiping, Shanghai, Swatow, Tientsin, Tsingtao, Hongkong, Kowloon	Hongkong Dollar	20,000,000	114,873,950	837,943,852	1,130,667,559
Banco Nacional Ultramarino	Portuguese	Lisbon	1864	Macao	Portuguese Escudo	..	..	..	..
Deutsch-Asiatische Bank	German	Shanghai	1889	Canton, Hankow, Shanghai, Tientsin, Tsingtao	National Yuan	5,705,000	2,044,000	39,956,931	49,058,068
Yokohama Specie Bank	Japanese	Yokohama	1892	Canton, Hankow, Peiping, Shanghai, Tientsin, Tsingtao, Hongkong	Yen	..	..	..	..
Banque de l'Indochine	French	Paris	1899	Canton, Hankow, Kunming, Mengtsz, Peiping, Shanghai, Tientsin, Hongkong	French Franc	..	..	..	..
National City Bank of New York	American	New York City	1902	Canton, Hankow, Peiping, Shanghai, Tientsin, Hongkong	Dollar	..	..	..	..
Banque Belge pour l'Etranger, Extrême Orient	Belgian	Brussels	1902	Hankow, Shanghai, Tientsin, Hongkong	Belgian Franc	30,000,000	..	84,149,254	179,139,528
Nederlandsche Handel-Maatschappij	Dutch	Amsterdam	1903	Shanghai, Hongkong	Guilder	..	..	..	..
Seiryu Bank	Sino-Japanese	Dairen	1906	Tientsin, Tsingtao	Yen	..	..	..	..
Crédit Foncier pour l'Extrême Orient	Franco-Belgian	Brussels	1907	Hankow, Shanghai, Tientsin, Hongkong	Belgian Franc	70,000,000	12,009,689	15,099,112	107,903,728

Bank of Taiwan	Japanese	Taihoku	1911	Amoy, Canton, Foochow, Hankow, Shanghai, Swatow, Hongkong	Yen	..	..	..	..
Banque Franco-Chinoise pour le Commerce et l'Industrie	Sino-French	Paris	1913	Peiping, Shanghai, Tientsin	French Franc	50,000,000	45,000,000	253,843,398	418,935,522
Sumitomo Bank	Japanese	Osaka	1916	Shanghai	Yen	..	..	..	..
Mitsui Bank	Japanese	Tokyo	1917	Shanghai	Yen	..	..	..	..
Mitsubishi Bank	Japanese	Tokyo	1917	Shanghai	Yen	..	..	..	..
Shanghai Bank	Japanese	Shanghai	1917	Shanghai	National Yuan	100,000	25,000	1,031,662	1,235,238
Bank of Chosen	Japanese	Seoul	1918	Shanghai, Tientsin, Tsingtao	Yen	..	..	..	..
American Express Company, Inc.	American	New York City	1919	Peiping, Shanghai, Tientsin, Hongkong	Dollar	..	..	..	..
Banca Italiana per la Cina	Italian	Shanghai	1919	Shanghai, Tientsin	Dollar	1,000,000	199,585	1,066,889	5,028,593
Hankow Bank	Japanese	Hankow	1920	Hankow, Shanghai	Yen	250,000	183,330	1,703,817	3,128,894
Bank of Tientsin	Japanese	Tientsin	1920	Peiping, Tientsin	Yen	625,000	180,300	1,646,165	4,484,276
Bank of Tsinan	Japanese	Tsinan	1920	Tsinan, Tsingtao	Yen	250,000	..	..	..
Nederlandsch Indische Handelsbank	Dutch	Amsterdam	1920	Amoy, Shanghai, Hongkong	Guilder	..	..	..	..
Chase Bank	American	New York City	1920	Shanghai, Tientsin, Hongkong	Dollar	..	..	..	..
P. and O. Banking Corporation	British	London	1920	Shanghai, Hongkong	British Pound	..	..	..	..
Union Mobilière Société Française de Banque et de Placement	French	Shanghai	1921	Shanghai, Tientsin	National Yuan	2,000,000	299,442	1,674,295	4,377,131
E. D. Sassoon Banking Co.	British	Hongkong	1930	Shanghai, Hongkong	British Pound	500,000	175,000	4,790,163	7,361,519
Underwriters Savings Bank for the Far East	American	Shanghai	1930	Shanghai, Hongkong	National Yuan	500,000	125,000	2,676,268	3,604,004
Finance Banking Corp.	British	Shanghai	1932	Shanghai	Haikwan Tael	200,000	..	..	..
Tientsin Commercial and Credit Corp.	American	Tientsin	1932	Tientsin	National Yuan	50,400	1,162	261,750	722,566
Moscow Narodny Bank	British	London	1934	Shanghai	British Pound	..	..	..	..

Source: Annual reports of the banks, 1936; Ju-lin Foo, "Banking," *The Chinese Yearbook*, Shanghai, 1937, p. 536; *The Chinese Bankers Yearbook*, Shanghai, 1936.

Deposits. As a general rule, foreign banks in China accepted current, or demand, accounts and fixed, or time, deposits in the common form used abroad; Japanese banks also had so-called "special current accounts" which differed from the usual current account in that they were withdrawable only by passbook entries and were, therefore, less frequently drawn upon than the checking accounts. Deposits were made and accounted in various currencies, mainly in the official currency of each bank, but also in other foreign currencies, in the Chinese national and/or local currencies and, until 1933, in taels. As a consequence, changes in the figures of deposits (as they appeared in bank statements) partially reflected the changes which occurred in the exchange rates between the official currencies used by the banks and any other currency in which deposits were accounted. Figures of increase or decrease in deposists tended, therefore, to be misleading, especially during periods of monetary disturbance. With these basic limitations, it is apparent that deposits in foreign banks expanded steadily until 1930; in the following years they maintained a rather stable level with minor oscillations and a certain tendency to contract. In 1930 the Hongkong and Shanghai Banking Corporation showed current accounts amounting to Hk$629.4 million and fixed accounts amounting to Hk$295.9 million; at the end of 1936 its deposits amounted to Hk$649.3 million and Hk$188.6 million, respectively.

No information is available with regard to deposits of branches of foreign institutions, but the amount undoubtedly was very large, particularly in the case of British and American banks, which were the traditional depositaries for the Chinese capitalists. These deposits were largely in the form of current accounts, although trust funds amounted to considerable sums in a few instances.

According to their source, deposits may be classified into official and private.

Official deposits were the funds kept for the account of public authorities, either foreign or Chinese. Most of the foreign banks acted as Treasury agents for their respective Governments and, by reasons of political relations and by right of extraterritoriality and autonomous administration, they administered the funds of their national diplomatic, military and judiciary authorities located in China.

These funds usually ran into substantial figures. The expenditures of foreign Governments in China were estimated by E. Kann at around CN$100 million (or $30 million) during a normal pre-1937 year. Funds of the foreign municipalities and agencies of foreign concessions were likewise administered by foreign banks. In the year preceding the Sino-Japanese conflict, the total income of the International Settlement and of the French Concession in Shanghai amounted to about CN$40 million, and that of the other foreign concessions (in Tientsin: British, French, Italian and Japanese; in Hankow: French and Japanese; in Canton: British and French, and in Amoy: the International Settlement) amounted to about CN$5 million; the revenue of the British colony of Hongkong was slightly less than Hk$30 million, and that of the Portuguese colony of Macao was about CN$5 million.

The payments of the Boxer indemnities were originally included among the official deposits with foreign banks. The German, Austrian, Russian and Italian indemnities ceased to exist to all intents and purposes by 1934. The first two were canceled by the war and the other two were unconditionally remitted in 1924 and 1933 respectively; all four were used until January 1936 as security for China's internal loans.[3] The French and the Belgian indemnities were fully converted into two separate foreign loans in 1925 and 1928, and a foreign loan was issued on a share of the British indemnity in 1934. The Japanese indemnity continued to be paid in sterling to the Yokohama Specie Bank in London, the annual payment amounting to £393,897. All other portions were remitted to China under various agreements (with the United States in 1908 and 1925, with Great Britain in 1930 and with the Netherlands in 1933) and were placed under the administration of Sino-foreign boards of trustees. The funds were thereafter deposited with the Central Bank of China and other modern banks, and the only balance which continued to pass through the foreign banks

[3] The German for the 20 Year (1931) Short-Term Loan (CN$80 million), the Austrian for the Public Safety Bonds of 1926 (CN$2 million), the Russian for the 7th Year (1918), 6 Per Cent Loan (CN$45 million) and for the Russian Indemnity Fund Certificates of 1934 (CN$44 million). With the consolidation of all internal issues into a big loan of CN$1,460 million in 1936, these loans lost the privileged rank on the customs revenue, as granted previously by their security on the Boxer Indemnity.

was that used for services of foreign loans or for other purposes abroad.

During the 'twenties, the Hongkong and Shanghai Banking Corporation held customs and salt receipts (with minor portions allotted to the Banque de l'Indochine and to the Yokohama Specie Bank), which served as security for the payments of the principal and interest on foreign loans. At the end of 1928 the National Government carried on a reorganization of the Salt Inspectorate and of the Customs General Inspectorate, and placed them under the immediate control of the Ministry of Finance. At the same time the custody of the revenue, which was entrusted to the Inspectorates, was transferred to the Ministry of Finance, which in turn deposited the main portion of the funds, the ordinary balance of which averaged more than CN$100 million, with the Central Bank of China. In 1932 the transfer of the balance to the Central Bank of China was completed and only pension funds of the foreign personnel continued to remain on deposit with foreign banks.

Other official funds of a similar kind were the sums deposited on account for foreign loans. Various loan agreements required that deposit of installments for payments of interest or principal be made at least fourteen days and sometimes twenty days or more before the due date, and the administrations of various railways were further required to deposit with the serving banks all surpluses of the net revenue up to an amount sufficient to cover the following year's installments of interest and principal. In some cases all the receipts had to be deposited with the serving bank.

The loans secured by the revenue of the Maritime Customs were constantly honored. Three foreign loans were issued with the security of the remitted portions of the Boxer Indemnity.[4] In 1937 total installments and interest on all loans with charges on the customs amounted to £2.5 million and to $4.4 million, payable into the Hongkong and Shanghai Banking Corporation, the Banque Belge pour l'Etranger, the Banque de l'Indo-

[4] These loans were the Chinese Republic 5 Per Cent Gold Loan of 1925 (on the French share, for satisfying the far eastern creditors of the defunct Banque Industrielle de Chine and for educational purposes); the Chinese Republic 6 Per Cent Loan of 1928 (on the Belgian share, for railway material and educational and charitable purposes); the Chinese Government 23rd Year (1934) 6 Per Cent Pound Sterling Indemnity Loan (on the British share, for completion of the Canton-Hankow Railway).

chine, the Yokohama Specie Bank, the Banque Franco-Chinoise and three Government banks (the Central Bank of China, the Bank of China and the Bank of Communications). Of the loans secured on the salt revenue, only the China Imperial Government 4 Per Cent and 5 Per Cent Gold Loan of 1908 was regularly serviced to the Hongkong and Shanghai Banking Corporation and the Banque de l'Indochine. The Crisp Loan of 1912 remained in arrears with capital installments, but it was entirely covered in 1936 and 1937, payments being made to the Chartered Bank of India, Australia and China and to the Hongkong and Shanghai Banking Corporation.

All the railway loans fell in default between 1920 and 1933, on both principal and interest, with only three exceptions.[5] Important readjustments of loans in default took place in 1936 and 1937 by agreements between the Ministries of Railways and Finance and the creditors represented by foreign banks (the Hongkong and Shanghai Banking Corporation, the Deutsch-Asiatische Bank, the Chartered Bank of India, Australia and China, and the Banque Belge pour l'Etranger). Overdue interest was either canceled or reduced. In the latter case, two different methods were applied. First, a new interest-bearing bond was issued equal to one fifth of the accumulated overdue interest. Second, a non-interest-bearing bond was issued for the overdue interest, calculated at a rate lower than that originally owed on the principal. Repayment of the capital was spread over a long period from twelve to fifty years, beginning in 1936, 1937 and 1940. New interest rates were fixed at 1½ to 2½ per cent, later to be increased to 4 and 5 per cent.

It is impossible to estimate the net balance which was kept by the foreign banks in official accounts during the years prior to 1937; it was certainly very large and played an important part in their operations, since it provided the banks with fixed

[5] Loans on which full payments were maintained were the China Imperial Railways 5 Per Cent Gold Loan of 1898 (Peking-Mukden), on which amount £80,500 was paid annually into the Hongkong and Shanghai Banking Corporation; the Imperial Chinese Government 5 Per Cent Shanghai-Hangchow-Ningpo Railway Loan, which was fully redeemed by 1936 and was replaced by a new loan for the completion of the line, issued by the British and Chinese Corporation (Agent: Hongkong and Shanghai Banking Corporation) and by the China Development Finance Corporation (Agent: Bank of China) for £1.1 million at interest of 6 per cent and redeemable between 1941 and 1960; and the 6 Per Cent Treasury Notes of the Tsingtao Railway, due in 1938 (the serving bank was the Yokohama Specie Bank, the 1937 installment was £66,000).

funds, free of charges, which could be invested on especially good terms.

Private deposits originated chiefly from foreign nationals and from Chinese capitalists. Local American banks particularly attracted small savings from the White Russian community.[6] The largest amount, however, was represented by the current accounts of foreign firms and by the funds of foreign religious, educational and charitable institutions. Business investments and nonprofit property owned by foreigners were estimated by Remer in 1931 at slightly less than $2,000 million, Hongkong included, but Manchuria excluded, and approximately $10 million or $15 million was annually remitted to China from abroad for religious and charitable purposes. Foreign activities in China therefore supplied a substantial amount of current deposits to foreign banks. Deposits from the Chinese may be grouped under three items. First, deposits of Chinese firms declined after 1930, when modern banks began to offer the same facilities on fair security and on better terms than foreign banks were able or willing to provide. Moreover, since the payment of customs duties was made through the Central Bank of China after 1928, and in Customs Gold Units beginning 1930, Chinese as well as foreign firms became accustomed to maintain a current account in Customs Gold Units with this bank, instead of an account in taels with the Hongkong and Shanghai Banking Corporation, as they did previously.[7] Second, savings of officials, politicians, warlords and of the bourgeois element of China in general continued to represent the bulk of the fixed deposits, especially in the case of the Hongkong and Shanghai Banking Corporation and of the National City Bank. Third, the so-called "bad money," or wandering funds searching temporary safety, had accumulated in foreign banks to a considerable extent throughout the political crises of China.

In general, it may be said that the supply of funds to the foreign banks was always abundant, although there was no definite increase and a decline was somewhat noticeable during the years immediately preceding 1937.

[6] The American-Oriental Banking Corporation, for instance, had some CN$3.5 million of Russian deposits, out of CN$8.3 million of total deposits.

[7] The Customs Gold Unit was an accounting currency with a gold content of 60.1866 centigrams, which was substituted in 1930 for the Haikwan Tael, previously used as the customs accounting currency. The exchange of the C.G.U. with the other currencies was fixed daily by the Central Bank of China.

Silver Stocks. Before the monetary reform of 1935, foreign banks used to keep their reserves in silver bars and coins: they were the money bags of the country, through which all international movements of white metal were passing. In 1921 nearly 70 per cent of the silver stocks of Shanghai was held by the foreign banks, but in the following years their importance as money-keepers was somewhat lessened, and in 1931 they held only 33 per cent of the Shanghai silver stock. During the two years following, as a result of the spectacular inflow of silver into the vaults of Shanghai, holdings of the foreign banks rose to over 50 per cent of the total. A reversal in trend followed very rapidly in 1934, however, when silver was exported by the foreign banks at unprecedented speed. Stocks in Shanghai were depleted until April 1935, when a "gentlemen's agreement" between foreign banks and Chinese authorities was reached through the good offices of Dr. T. V. Soong, newly appointed to the chairmanship of the Bank of China, in order to restrain the banks from making further shipments of silver abroad. It is impossible to state how effective the agreement was, since despite the fact that little silver was left in Shanghai, the decline in the stock of the foreign banks continued. It fell from CN$55 million at the end of April to CN$36.7 million in September 1936. This decline, however, may have been caused by buying operations of the Government banks, in order to cover their expanding note issue and for shipments to the interior, where the stocks had been depleted by exports and hoarding.

The monetary reform of November 1935 provided for nationalization of silver and for a managed currency. At about the same time the United States Treasury gave indications that the price of silver was going to be decreased. Foreign banks found themselves with reserves of a highly problematical value. However, as they entertained serious doubts regarding the new currency, they were reluctant to give up their silver holdings. Local conferences followed between foreign banks and officials of the Currency Reserve Board (in Shanghai, Tientsin, Tsingtao, Tsinan, Hankow and Canton), and by the middle of January 1936 the first agreement was reached in Shanghai. Although no official statement was issued, it was understood that the Central Bank of China had agreed to issue legal tender (national yuan) notes against delivery by the foreign banks of

TABLE 5

STATISTICS OF SILVER STOCKS IN FOREIGN BANKS

December 1928–1936
(In thousands of national yuan)

	1928	*1929*	*1930*	*1931*	*1932*	*1933*	*1934*	*Nov. 6 1935*	*1935*	*Sept. 30 1936*
SHANGHAI										
British Banks										
Hongkong and Shanghai Banking Corporation	31,080	48,637	60,109	29,763	71,316	83,921	7,476	8,390	8,392	..
Chartered Bank of India, Australia and China	4,637	4,796	6,056	7,065	21,622	71,658	2,800	5,570	4,915	..
Mercantile Bank of India	480	719	690	1,069	1,513	1,737	1,153	1,130	417	..
P. and O. Banking Corp.	660	520	519	1,279	2,858	2,629	1,568	450	451	..
Total	36,857	54,672	67,374	39,176	97,309	159,945	12,997	15,540	14,175	..
Japanese Banks										
Bank of Chosen	604	410	450	1,199	519	1,459	2,800	3,040	2,629	2,629
Yokohama Specie Bank	10,589	13,433	6,079	11.707	28,543	20,208	4,520	1,860	1,859	1,859
Sumitomo Bank	1,149	799	689	2,318	1,419	1,526	1,630	1,860	1,863	863
Mitsui Bank	1,055	2,438	2,177	3,383	2,638	6,406	420	1,700	1,698	1,698
Bank of Taiwan	1,571	5,095	3,087	3,717	7,994	7,535	4,837	1,250	1,396	1,396
Mitsubishi Bank	1,192	659	763	2,004	707	1,179	2,461	1,190	750	750
Total	16,160	22,834	13,245	24,328	41,820	38,313	16,668	10,900	10,195	9,195
American Banks										
National City Bank of New York	5,995	12,270	7,773	8,969	20,368	25,691	14,877	4,540	4,550	..
Chase Bank	1,359	799	1,009	2,827	2,128	3,840	1,020	880	883	..
American Express Co. Inc.	..	..	..	..	1,429	2,526	690	780	782	..
Total	7,354	13,069	8,782	11,796	23,925	32,057	16,587	6,200	6,215	..
Other Banks										
Banque de l'Indochine	3,496	1,198	1,059	1,878	5,835	17,768	900	4,130	2,062	..
Banque Belge pour l'Etranger	993	919	1,686	2,658	3,158	6,963	3,095	1,550	1,551	..
Deutsch-Asiatische Bank	803	807	943	1,559	1,838	2,253	670	1,500	..	..
Nederlandsch Indische Handelsbank	380	381	430	1,568	2,068	2,893	1,000	1,320	716	..
Nederlandsche Handel-Maatschappij	919	1,279	851	1,489	4,076	5,906	975	1,130	630	..
Banca Italiana per la Cina	589	464	464	453	519	1,500	915	370	366	..
Banque Franco-Chinoise	709	450	829	1,978	4,497	8,062	895	280	249	..
Total	7,889	5,498	6,262	11,583	21,991	45,345	8,450	10,280	5,574	..
Grand Total	68,260	96,573	95,663	86,883	185,045	275,660	54,702	42,920	36,159	9,195
Percentage to total silver stock in Shanghai	40.10	39.98	36.52	32.64	44.22	50.35	16.32	13.61	13.12	10.24
TIENTSIN										
Foreign banks: Total	..	..	..	..	..	50,992	9,509	9,430	10,230	5,400
Percentage to total silver stock in Tientsin	..	..	..	..	..	48.45	21.82	22.70	24.09	12.03

Source: *Financial and Commercial Monthly Bulletin*, Shanghai; *Far Eastern Financial Notes*, December 19, 1935 (data for November 6, 1935).

a sum consisting of 60 per cent in silver and 40 per cent in securities, including bonds, stocks and debentures; to pay interest for two years on the silver delivered, and to make a deposit of equal amount at the banks turning over the silver, receiving a lower rate than the interest paid to the banks on the silver.[8] Similar agreements were reached in other cities, and silver stocks were thus surrendered by all banks, with the exception of the Japanese, which adopted a position of watchful waiting until March 1937, when they decided to follow the common policy.[9] The conditions stipulated represented an actual premium on the silver delivered.

A certain pressure on foreign banks was brought by the British Government. On November 4, 1935 the British Ambassador in Nanking issued an Order-in-Council forbidding British subjects in China to make payments in silver of any debt or other obligation. An embargo was placed on the white metal in Hongkong on December 5, 1935 by a Currency Ordinance, which nationalized all the silver in circulation or in bank reserves, and set up an Exchange Fund held by the colonial Government. The specie reserve of the three banks of issue, the Hongkong and Shanghai Banking Corporation, the Chartered Bank of India, Australia and China and the Mercantile Bank of India, amounting to Hk$98.9 million (Hk$43 million less than at the end of 1934), was taken over by the colonial Government against delivery of certificates of indebtedness for the same amount. The steps taken by the Hongkong Government were in harmony with the reports of the Commission on Currency of 1931 and of the Commission on Trade of 1934-1935, which had come to the conclusion that "Hongkong is economically a part of China, and must remain on a silver standard so long as China does." But the presence in the Far East of Sir Frederick Leith-Ross, the official British adviser to the Chinese Government, gave rise to reports that British authorities had done more than simply back China's currency reform of 1935.[10]

[8] *Finance and Commerce,* January 1 and 8, 1936.

[9] Following a visit of the Japanese Economic Mission to China, in March 1937, the decision to deliver the silver was reached, and conferences were opened with Chinese officials for the determination of the price and other conditions. *Finance and Commerce,* March 10, 1937. The silver was handed over on April 1, 1937.

[10] These rumors were officially denied by Sir Frederick Leith-Ross in his statement to the Shanghai Press of June 22, 1936. Friedman, I. S., *British Relations with China: 1931-1939,* New York, 1940, pp. 67-70.

Issue of Bank Notes. The silver stocks were kept by foreign banks both as general banking reserves and as special reserves against the note issues. The circulation of bank notes issued by the foreign banks was both general and legally unrestricted. Foreign bank notes may be divided into two groups: bank notes issued in territory under foreign sovereignty, and bank notes issued in Chinese territory. To the first type belonged the notes issued in Hongkong, Dairen and abroad; the second type consisted of the notes issued by the offices of foreign banks situated in China.

Bank notes were issued in Hongkong by three banks, the Hongkong and Shanghai Banking Corporation, the Chartered Bank of India, Australia and China and the Mercantile Bank of India. Their total note issue in June 1937 amounted to Hk$188.5 million, of which about Hk$30 million to Hk$40 million was estimated to be in circulation in southern China. A small amount of notes issued by the International Banking Corporation were in circulation in Canton. Notes issued by the Banque de l'Indochine in French Indo-China and through its agencies in China circulated in Yunnan and Kwangsi.

The Yokohama Specie Bank used to maintain a silver note issue in yen from its office of Dairen, and these notes circulated among Japanese in northern China along with those of the Bank of Chosen. Notes issued by the Bank of Taiwan circulated among Japanese residents in southern and northern China.[11] Yen bank notes of the Bank of Japan appeared in circulation in Shanghai at the end of 1935, with little success.

At the middle of 1935 some CN$3 million in foreign bank-notes was in circulation in Shanghai and about CN$1.5 million in Tientsin. These had been issued by the Hongkong and Shanghai Banking Corporation, the Chartered Bank of India, Australia and China, the Mercantile Bank of India, the International Banking Corporation, the Banque Belge pour l'Etranger and, for very small amounts, by the American-Oriental Banking Corporation and the Deutsch-Asiatische Bank. Foreign bank notes were also in circulation in Hankow (Hupeh), in Changsha (Hunan) and in a few other cities with foreign bank offices. However, the circulation of foreign bank

[11] Japanese notes were withdrawn from Manchuria beginning in 1937 as part of the plan to introduce a unified currency issued by the Central Bank of Manchou.

notes was noticeable only in southern China (where the Hongkong dollar remained the general medium of exchange for the foreign community and for all inter-port transactions) and to a lesser extent in Tientsin. In general, in 1936-1937 the problem of foreign currency seemed to have lost its traditional importance.

OPERATIONS OF THE FOREIGN BANKS

There was hardly any legal restriction imposed upon the operations of the foreign banks. The Hongkong and Shanghai Banking Corporation was authorized, by the chartering Hongkong Ordinance, to carry on "the business of banking, and as ancillary thereto the other businesses," contained in twenty-three long paragraphs of Article 3 of the bank's regulations. No limitation whatever was set on operations, investments, securities, transactions, promotions or on "all such other acts and things in all parts of the world as shall seem to the bank incidental or conducive to the attainment of the above objects or any of them."[12]

Foreign Loans and Bank Investments. Under the National Government, only three new issues of foreign bonds were made through foreign banks; namely, the Chinese Republic 6 Per Cent Loan of 1928, the Chinese Government 23rd Year 6 Per Cent Pound Sterling Indemnity Loan of 1934 and the Chinese National Government 6 Per Cent Shanghai-Ningpo-Hangchow Railway Completion Loan of 1936.[13]

Foreign banks were the natural credit agencies of foreign communities in the Far East. The types of credit and the procedure for granting it lacked the strict requirements demanded

[12] *Ordinance and Regulations of the Hongkong and Shanghai Banking Corporation,* Hongkong, 1929, p. 80.

[13] The Chinese Republic 6 Per Cent Loan of 1928 was issued at a price of 82, for a total amount of CN$43.9 million, through the Banque Belge pour l'Etranger, redeemable by amortization between 1928 and 1941. The Chinese Government 23rd Year (1934) 6 Per Cent Pound Sterling Indemnity Loan was issued at a price of 90, for a total amount of £1.5 million, redeemable in twenty-five years beginning in 1935, through the Hongkong and Shanghai Banking Corporation, the Central Bank of China and the Bank of Communications. The Chinese National Government 6 Per Cent Shanghai-Ningpo-Hangchow Railway Completion Loan of 1936 was issued at a price of 94, for a total amount of £1.1 million, secured on the revenue of the line, redeemable in twenty-five years beginning in 1941, through the British and Chinese Corporation (Hongkong and Shanghai Banking Corporation) and the China Development Finance Corporation (Bank of China, the Central Bank of China and the Bank of Communications).

by banks in western countries. In general, while some banks (such as the British) lent assistance to promoters of commercial and industrial enterprises, other banks, especially the branches of American banks, limited themselves to the financing of existing enterprises on a short-term basis.[14]

Loans on real estate and investments, either made directly or through finance and real estate companies, were common practice to various extents before 1932, but afterward this type of credit nearly ceased and new advances were then limited to 30 or 40 per cent of land values. The extent to which foreign banks were connected with this type of credit is unknown. It is believed that only 10 per cent of the funds of the Hongkong and Shanghai Banking Corporation were invested in real estate, with special preference for the Hongkong public utilities, particularly wharves. In some cases such investments assumed speculative proportions; e.g., the American-Oriental Banking Corporation, and brought about bankruptcy to the institution. Savings banks, such as the Underwriters Savings Bank, and special institutions, such as the Crédit Foncier d'Extrème Orient, carried 50 to 70 per cent of their total assets in mortgage deeds and real properties throughout the depression.

Investments in bonds and shares usually were important in a foreign bank's portfolio. At the end of 1936 the Hongkong and Shanghai Banking Corporation had more than Hk$300 million, or one third its assets, invested in British, Indian, colonial and other securities. Advances were made to individuals and brokers on Government or private securities, with special preference for those with a worldwide market and which were officially quoted on national stock exchanges. Certain local foreign securities were also usually acceptable as collateral for loans. These included public utilities such as Shanghai Power, Shanghai Waterworks, Shanghai Telephone, L'Energie Electrique de Tientsin and a few land debentures, in addition to rubber shares in Shanghai and Philippines gold mines shares in Hongkong.

[14] This fact was an object of criticism and the basis of a proposal by F. E. Lee, *Currency, Banking and Finance in China,* Washington, 1926, pp. 117-9, and by an American economic mission to the Far East (*American Trade in the Orient,* New York, 1935, p. 65) which suggested the establishment of an American bank "well financed, with headquarters in China, prepared to enter into the financial field."

Financing of Foreign Trade. The largest part of credit operations of foreign banks was, however, connected with the financing of foreign trade. Uniform rules did not exist, but some customs were generally followed.

In export financing foreign banks granted so-called "packing credits" to the exporter in the form of overdrafts. The amount of these credits was supposed to cover only the expenses of packing and shipping the goods, but in effect it also covered the purchase of the goods, since it was granted up to about 80 per cent of the value of the merchandise and was generally renewed or extended at maturity. These overdrafts were secured either by specified goods or by all the exporter's goods kept in his own go-down (warehouse) and in the go-downs of the bank and others. The interest charged varied from 5 to 7 per cent a year. In the case of packing credits granted by overdraft on unspecified goods, an unscrupulous exporter could obtain multiple advances on the security of the same goods from various banks and leave the creditors with the low priced goods after selling out the most marketable merchandise.

When the goods were ready for shipment, several forms of financing were open to the exporter. He could obtain a letter of credit from the importer and settle the packing credit by delivering to the bank a bill of exchange drawn on the importer, together with the shipping documents. The letter of credit was seldom used, however, and when export credit was obtained through the foreign importer, it was normally in the form of the so-called "documentary credit." This instrument has been defined as an authorization by the importer (abroad) to his banker (in China or abroad) to make certain advances to the exporter (in China) on the responsibility of the importer.[15] It was in effect a special type of irrevocable confirmed credit opened by a bank at the instance of an importer in favor of an exporter. The bank agreed to make advances on the bills the exporter might draw upon the importer, and the importer agreed to accept and to pay such bills at maturity, up to a certain amount and against delivery of the shipping documents issued on the exported goods, duly hypothecated in favor of the bank and kept as security for the payment of

[15] Spalding, W. F., *Eastern Exchange, Currency and Finance,* London, 1918, pp. 366-7; Spalding, W. F., *Foreign Exchange and Foreign Bills,* London, 1932, pp. 231-2.

the bills. The packing credits could therefore be settled through the bills drawn by the exporter upon the foreign importer and paid by the bank crediting the exporter in the name of the importer. Since the exporter, on the other hand, was not relieved from the liability attached to the drawer of a bill of exchange, the bank was covered by the security of a joint responsibility.

More usual, however, was the issue of the "trust receipt." The bank which opened the packing credit permitted the shipment of the goods in question against delivery of the shipping documents and acceptance of a trust receipt by the exporter, by which he (the exporter) agreed that the goods shipped would continue to remain as security for the loan. If delivery of the documents from the bank to the foreign importer took place against cash payment, the risk assumed by the bank was limited; but usually the bank delivered the documents to the importer against his endorsement of the trust receipt issued by the exporter, and authorized the importer to move the goods still unpaid to a warehouse for his own account. However, if all goods deposited in the importer's warehouse were previously hypothecated for overdrafts or loans granted to him by other banks, the bank which financed the export on the trust receipt lost the privileged security of the goods, which became part of the security for the overdrafts or loans granted by the other bank to the importer. This system of trust receipt was in existence from the beginning of foreign business intercourse in the Orient, and contributed greatly toward the development of foreign trade in China, but it had no foundation in law and was never recognized by the British courts.[16] Trust receipts, as well as packing credits, were both based on personal confidence, which characterized the special way of dealing in the Orient among both the foreign and native communities.

Import financing was also done in different ways. If the importer was a local foreign firm, credit was usually granted

[16] In 1932 the Chartered Bank of India, Australia and China held trust receipts upon some goods deposited in a go-down of an Indian merchant who went into bankruptcy. The Imperial Bank of India had taken as security all the goods deposited in the go-down of the merchant on an overdraft which had been opened some years earlier. The case went to the British Court, which denied any legal validity to the trust receipt, and the goods were thus assigned to the Imperial Bank of India. See *Finance and Commerce*, September 28 and October 5, 1932 (comment by O. Fischer).

directly by a local foreign bank. If the importer was a Chinese firm, credit was customarily granted by a native bank and transferred to a foreign bank through the issue of a native bank order. This method of financing lost importance, however, when circulation of the native bank order became restricted and modern banks began taking over the direct financing of imports.

American firms usually required a confirmed bank credit and payment against delivery of the shipping documents. In most cases the financing of imports was handled by the foreign exporter, who secured a documentary bank credit, on a joint responsibility of the exporter and the importer. Terms ran from ninety or 120 days for consumption goods, to two years or more for capital goods. These and other facilities, such as installment payments and combined barter transactions, were common especially among British, Belgian, French, German and Japanese banks which were connected with engineering works and commercial and shipping enterprises.

An important development in the British system of commercial credit to China took place in 1936. The British official Export Credit Guarantee Department agreed to assume the risk on a given percentage and for a given total amount of exports to China, in order to relieve the British manufacturer from unbearable losses. The precise terms of the guarantee remained secret. A special office was established in Shanghai for the examination of the applications made by British firms. This method may be considered as a combination of insurance and Government subsidy.

As a matter of fact, the facilities offered to foreign trade in China were always larger than in any other country. The danger usually consisted of overtrading positions, rather than credit difficulties. During 1932, for instance, when prices were slackening rapidly, importers were accumulating large stocks of goods financed through documentary credits, the ultimate risk thus being placed upon the foreign exporter. Proposals were made to the banks at the time to require a special margin from the importer—a cash deposit, a native bank guarantee or a cash payment of 25 per cent of the credit. However, the foreign banks were unable to reach any agreement, owing to the intense competition existing among them.

During the following years facilities for foreign trade were

further enlarged by the expansion of modern banks in the foreign field. These banks took over some of the business previously transacted through foreign institutions. Moreover, the National Government itself entered into the business of foreign trade, either on barter agreements, as with German firms, or as a direct buyer and seller, by purchasing railway and other materials through the remitted funds of the Boxer indemnities, and by selling sesamum oil, groundnuts and other products through special agencies. Financing of this trade was made through the Bank of China, which handled all official foreign exchange transactions. These facts explain the acute scarcity of commercial paper in the private market during 1936 and 1937, a period of great expansion in foreign trade.

Transfer of Foreign Remittances. The transfer of foreign remittances to China was another important operation of the foreign banks. In the years preceding the Sino-Japanese hostilities, remittances from Chinese abroad were estimated at CN$250 million to CN$300 million (or approximately $85 million). Large parts of these remittances came from the South Seas and southern Asia, and these were made through the Hongkong and Shanghai Banking Corporation, the Nederlandsch Indische Handelsbank and the Banque de l'Indochine; from Formosa and Japan through the Bank of Taiwan, and from the United States through the National City Bank of New York. The sums remitted through modern banks, such as the Bank of Canton, the Chinese Overseas Bank, the Bank of East Asia, a few native banks and the overseas branches of the Bank of China were not of great importance before 1936.

Remittances were almost exclusively collected in a few ports; namely, Hongkong, Swatow (Kwangtung) and Amoy (Fukien). They were traditionally accounted in Hongkong dollars and transferred to the interior through Chinese banks. In handling remittances, the foreign banks were in a more favorable position than the modern banks, owing to a larger net of branches outside of China, and to the fact that overseas Chinese were accustomed to send their savings through Hongkong. The introduction of the national currency in southern China and the establishment of foreign branches by the Bank of China and of foreign correspondents by the Kwangtung Provincial Bank resulted in a diversion to modern banks of a portion of the remittances after 1935.

EXCHANGE RATE MANAGEMENT

The issue and payment of drafts in foreign currencies requires a previous operation; namely, the fixing of the exchange rate at sight and forward. In the 'twenties the Chinese market was entirely dependent for it upon the foreign banks. The opening rates of the Hongkong and Shanghai Banking Corporation were published at 9.30 a.m. in Shanghai and at 10 a.m. in the other branches, and these were accepted as the official quotations in the market. They were expressed in sterling on the basis of the T/T rate on London, while for other currencies the London cross-rate was used. In 1930 the National Government introduced the Customs Gold Unit, an accounting currency based on a hypothetical pure gold content of 60.1866 centigrams (equivalent to the gold weight of the "Sun," the monetary unit proposed by the Kemmerer Commission), and the Central Bank of China began quoting its exchange rate in taels and yuan on the basis of the T/T rate of Shanghai on New York.

After the United States went off gold and the exchange rate between Shanghai and New York could no longer be used, two important changes took place. Beginning in March 1934 the exchange of the Customs Gold Unit in silver yuan was calculated according to the London rate of gold ingots on the previous day and the T/T spot rate on London. After September 1934, the daily rate of the Customs Gold Unit thus established was used for figuring the standard price of gold in the Shanghai market, on the basis of which settlement could be legally effected for incomplete forward gold transactions and "no opposition could be brought to the fore by either party."[17] The steps taken by the Central Bank of China tended to bring the exchange of the silver currency under its control and to restrict the opportunity for arbitrage operations, as these were effected through fictitious buying and selling of gold bars in the Shanghai market.

The position of the foreign banks was, however, only slightly impaired by these measures, because as long as silver was the monetary unit of the country, foreign exchange rates frequently diverged from the price of silver expressed in gold, and these

[17] Arts. 55-57 of the Revised Business By-Laws for the Shanghai Gold Stock Exchange, Ltd.

variations permitted profitable manipulations. During the period from 1931 to 1935, at first owing to the rapid decline in the price of silver and later owing to its rapid rise, foreign banks often had difficulty in obtaining at current rates forward exchange to cover their daily transactions. As a result, they increased the margins between buying and selling rates, by lowering purchasing rates or raising selling rates or both, thereby often obtaining considerable profit. Cross-rate operations were in fact made not only for genuine requirements, but also for speculative purposes, especially during the rapid changes in international exchange rates. Shanghai was a typical speculative market on bullion and exchanges, and foreign banks developed into the most important medium through which such operations were carried out.

Following the currency reform of 1935, foreign banks liquidated most of their silver and turned the rest over to the Currency Reserve Board. The Government banks, in turn, sold the silver abroad in exchange for foreign currency. Some silver was sold in the open markets of Bombay and London, but most of it was transferred by special arrangements to the Treasury of the United States. Simultaneously a considerable amount of foreign trade was taken over by the National Government directly, and the paper arising from such commercial transactions was transferred entirely to the Bank of China. Thus, modern banks began to compete successfully with foreign banks in the financing of foreign trade. No data are available on the amount of foreign transactions handled by modern banks in 1937, but even without accepting foreign unofficial estimates of about 60 per cent of the total exchange operations of the Shanghai market, it may be assumed that the importance of the foreign banks in determining the foreign exchange rates had decidedly declined.

The role played by the foreign banks in the fixing of the foreign exchange rates between 1935 and 1937 became one of co-operation rather than leadership. With the exception of the Japanese banks, whose branches in China adopted a policy of watchful waiting until March 1937, all foreign banks followed the example of the Hongkong and Shanghai Banking Corporation whose Shanghai manager "kept in close touch with the Chinese financial authorities, and like the other lead-

ing foreign banks, co-operated with them as and when possible."[18]

This policy was fully accepted by the authorities of Hongkong. Following the nationalization of silver on December 5, 1935, the local note issue was secured up to a fixed amount by sterling credits. These credits included the certificates of indebtedness delivered by the colonial Government in exchange for silver, and the sterling securities deposited with the Crown Agent of the Colony. Above this limit, a 100 per cent reserve consisting of sterling notes was required for any dollar note issued.

The control of the exchange rates was entrusted to a committee consisting of the Colonial Treasurer and the general managers of the banks of issue (the Hongkong and Shanghai Banking Corporation, the Chartered Bank of India, Australia and China and the Mercantile Bank of India). The new Hongkong currency was defined as a "sterling managed currency." However, the policy followed after November 1935 was directed toward bringing the local exchange rates into harmony with Shanghai. While the official rate of Shanghai on London remained unchanged from November 1935 to August 1936 at 1s. 2.375d., the rate of Hongkong on London (fixed at 1s. 4.4375d. in December 1935) was frequently altered and then stabilized in August 1936 at 1s. 2.8788d. As a result, the premium of the Hongkong dollar on the national yuan was lowered from 11.15 to only 2.82 per cent.

It was always generally recognized that "Hongkong is economically a part of China," and had, therefore, to keep in touch with the monetary changes of the country; but in the past, during the fall and rise in the prices of silver, a premium of as high as 30 per cent was usual on Hongkong notes over the silver and Shanghai currencies, and although proposals were advanced for readjustments, little was ever done. In 1935 for the first time, the Hongkong authorities manifested definite interest in readjusting the colony's monetary system into harmony with the national currency of China, just when the foreign banks in Shanghai were losing their traditional control over the exchange market. This attitude of co-operation by the foreign banks, and particularly the British, was a most im-

[18] Hongkong and Shanghai Banking Corporation, *Annual Survey for 1935*, Hongkong, 1936.

portant contribution toward the policy of stabilization pursued by the National Government; this new attitude, however, was a departure from their traditional leadership and independence in the field.

CLEARING AND INTER-BANK CO-OPERATION

Foreign banks maintained a strictly individualistic attitude, and co-operation or common policy beyond syndicates for the issue of loans was almost unknown among them. Local Foreign Exchange Bankers Associations were established under the presidency of the Chartered Bank of India, Australia and China, in Shanghai in 1917 and in Tientsin in 1924, with the aim of co-ordinating their business methods and for social purposes. A plan to introduce a clearing house, similar to and possibly connected with the Clearing House of the Shanghai Bankers Association, was started by American and other foreign banks in 1932, but it failed, apparently owing to the reluctance of two large British banks. However, a clearing group was formed in Shanghai by the so-called Bund banks, a term applied to members of the Foreign Exchange Bankers Association and a few modern banks.

This group consisted of the following banks:

Chartered Bank of India, Australia and China, Hongkong and Shanghai Banking Corporation, Mercantile Bank of India, P. and O. Banking Corporation, Bank of Chosen, Bank of Taiwan, Mitsui Bank, Mitsubishi Bank, Sumitomo Bank, Yokohama Specie Bank, American Express Co., Chase Bank, National City Bank, Banque de l'Indochine, Nederlandsch Indische Handelsbank, Nederlandsche Handel-Maatschappij, Banque Belge pour l'Etranger, Banca Italiana per la Cina, Deutsch-Asiatische Bank, Banque Franco-Chinoise, Central Bank of China, Bank of China, Bank of Communications, Commercial Bank of China, Kiangsu Bank, Joint Savings Society, Joint Reserve Board of the Native Banks Clearing Association.

Strictly speaking, there was no clearing system among these banks, and each one cleared independently through the Bank of China, which rendered the service of checking and crediting and debiting odd accounts of the balances.[19] Before the close of business, each bank sent a messenger to the other banks to collect the items due during the day. When all items were received, each debtor bank issued a clearing slip on the Bank of China to the account of the creditor bank for the

[19] Before the abolition of the tael (1933) this service was rendered jointly by the Bank of China and the Hongkong and Shanghai Banking Corporation.

balance due (the so-called class N.1 slips). The clearing banks were not required to keep any deposit with the Bank of China; they were allowed to draw the clearing slip because, disregarding odd amounts, the difference between debits and credits would be settled by cash payments or by call loans. Before the nationalization of silver in November 1935, the debtor banks used to issue to the creditor banks a "safe custody receipt," that is, a receipt for so much silver earmarked by the debtor bank for the account of the creditor bank.

The collection of foreign bank credits on a modern bank not belonging to the Bund group could be effected in two ways. The foreign bank could keep a deposit with a member bank of the Clearing House of the Shanghai Bankers Association and clear the checks through it, or the modern bank could keep a deposit with a Bund bank, through which a special clearing slip (the so-called class N.2 slips) was issued in favor of the foreign bank. For payments to modern banks, outside of the Bund group, foreign banks always used clearing slips of this second type, deposited with one of the modern Bund banks.

The credit items of native banks on foreign banks were sent to each foreign bank through the Joint Reserve Board of the Native Banks Clearing Association, which, being a member of the Bund group, cleared the balances through the Bank of China. Foreign banks sent their credit items on native banks to each one individually; native banks returned clearing slips (N.2) drawn on a modern Bund bank (usually the Joint Reserve Board); these slips were cleared through the Bank of China. In practice only the Bank of China and the Central Bank of China acted as agents for the inter-group collection. There is no doubt that this method of settling balances was rather cumbersome, but it was just another case of the strength of tradition in the Orient, even among foreign communities. In Shanghai it was often said that Hongkong people did not make use of the telephone, all transactions being made through memoranda transmitted by messengers. Be that as it may, it does not seem that Shanghai people went very far in the use of new methods of banking.[20]

[20] Chu, Percy, "The Various Methods of Bank Clearing in Shanghai," *Finance and Commerce,* August 21, 1935.

THE FOREIGN BANKS: CONCLUSION

In conclusion, it may be said that in the years immediately preceding the Sino-Japanese conflict, foreign banks were adapting themselves to the new political situation created by the National Government. Previously, foreign banks had conducted operations pertaining strictly to central institutions or domestic banks. They had been able to exercise a dominating influence, internally and externally, on the money market through their custody of public funds, customs and salt revenues and railway receipts, the issue of bank notes and the monopoly over foreign financial transactions. While native and foreign banks undoubtedly served legitimate and genuine economic needs, both prospered on the misfortunes, rather than on the fortunes, of the country.

It was only the exceptional conditions in which China found herself during the debacle of the Manchu Dynasty and the early period of the Republic which permitted the foreign banks to step into such operations. In Western countries, the domain of foreign banks is generally confined to foreign communities, foreign trade, foreign investments and foreign exchanges—a domain subordinate to the control of the money market by central and national institutions. In China, between 1935 and 1937, foreign banks were obliged to withdraw partially from their predominant position to these legitimate positions. The complaint that they were "forced out" created a general impression that they had previously occupied what might be called normal positions; this, however, was not the case. In addition to the loss of some of their privileges, they met with stiffer competition from the modern banks. The times of easy going, easy speculation and easy profits came to an end with the monetary reform of 1935.

Despite all this, their importance continued to be great, and their prestige survived the bankruptcies of some reckless activity. As long as the rights of extraterritoriality continued to be recognized and foreign communities continued to occupy a prominent position in the business world, foreign banks necessarily played a decisive part in the foreign exchange market, and their co-operation was needed by the monetary authorities of China. The position of the foreign banks in 1937 was one of "necessary co-operation" with, rather than "control" of, the Chinese official financial policy. This situa-

tion evidently represented a position of transition toward an ultimate logical "subordinate dependence" to the national institutions. This, however, could be brought about only by an autonomous political organization of the country.

OTHER FOREIGN INSTITUTIONS

Other foreign financial institutions did not develop in China so extensively as did banks. The International Savings Society, a French institution with head office in Shanghai, had a large number of branches and offices in the interior and a capital of 1 million taels and 8 million francs. It used to collect savings by a system of annual, semi-annual and quarterly installments on the basis of a membership share of CN$12 a month (full share), CN$6 a month (half share) and CN$3 a month (quarter share). At the end of fifteen years, lump sums of CN$2,000, CN$1,000 and CN$500, respectively, were payable to the three classes of members. The chief attraction of this savings plan was a grand lottery prize of CN$50,000 and a number of minor prizes ranging from CN$10,000 to CN$2,000, drawn every month for a total amount equivalent to one fourth of new deposits received. At the end of 1934 deposits amounted to CN$66 million, for the account of 130,000 members. The funds of the Society were utilized in various ways. Loans to the members amounted to 36 per cent of the total; loans to and investments in foreign enterprises in China accounted for 31 per cent; investments in and loans on Chinese Government bonds and Treasury notes made up 17 per cent, and loans and investments in real estate comprised 16 per cent.

In June 1935 the National Government issued the Savings Bank Law, which prohibited the practice of offering prizes to savings depositors (Art. 14) and provided that institutions offering such prizes were to wind up their business and to be taken over by the Central Savings Society, an affiliate of the Central Bank of China. The measure was evidently directed against the International Savings Society, which had been denounced for its speculation and "gambling" at the Second National Financial Conference in 1934.[21] The Inter-

[21] There was in existence another savings society with a lottery, the Société d'Epargne Franco-Chinoise, which, however, was transferred to Chinese ownership and control in 1926. Moreover, its importance was only slight, since its deposits did not exceed CN$4 million in 1934.

national Savings Society claimed rights of extraterritoriality and resorted to the law, but new measures were passed against Chinese subjects working for the prohibited institutions. In April 1936 the Society was forced to close its offices in the interior.

Some American finance companies had their head offices in Shanghai; namely, the China Finance Corporation, Inc., with a paid-up capital of 3 million taels; the China Bonds and Shares Co., Inc., with a paid-up capital of 1 million taels, and the Shanghai Loans and Investments Co., with a paid-up capital of 1.25 million taels. Other foreign finance companies were incorporated under the Ordinances of Hongkong; these included the International Investment Trust Co. of China, Ltd., with a paid-up capital of Hk$5 million, and the Commercial Investment Co. A large group of real estate finance companies grew during the land boom; the most important of these was the Central Properties, Ltd., incorporated in Hongkong with a capital of Hk$1.8 million, and the Shanghai Land Investment, a real estate firm closely connected with the Hongkong and Shanghai Banking Corporation with a capital of 7.0 million taels. The greatest crashes in this field occurred in 1935 among American companies and involved the China Realty Company and the Raven group which consisted of the Raven Trust Company, the American-Oriental Trust Company and the Asia Realty Company.

Most insurance business in China was in the hands of British firms. Among the few local foreign insurance companies, the two oldest were the Union Insurance Society of Canton, with several subsidiaries and with total assets of well over £6 million, and the Canton Insurance Office, Ltd., controlled by Messrs. Jardine, Matheson and Co. (the most important shipping and commercial firm of Hongkong with interests in the Hongkong and Shanghai Banking Corporation), having assets of more than Hk$17 million. The largest local foreign firm in China, however, was the International Insurance Co., Ltd., in Shanghai, with a paid-up capital of 3 million taels.

Foreign stockbrokers were members of the Shanghai Stock Exchange, which merged in 1929 with the Shanghai Shareholders Association, incorporated in Hongkong. A few of the largest brokerage firms of Shanghai acted for foreign brokers.

CHAPTER VII

THE MODERN MONEY MARKET

INTRODUCTION

The modern money market consists of Chinese public and private institutions, organizations and associations handling monetary transactions under the laws and regulations of the Chinese authorities and along the lines of modern business methods. In the years immediately preceding the Sino-Japanese war, this money market was highly centralized through chains of branches, interlocking directorates, financial combinations and public participation and control. Its centers were located in the modern commercial cities where foreign banks had developed during the last eighty years.

Institutions, organizations and associations forming the modern money market fall into the following groups:

(a) The central banking group, formed by public institutions having the functions of direction and control;

(b) The local official banking group, formed by public local institutions with only vaguely defined functions;

(c) The ordinary banking group, formed by institutions handling commercial, savings and special business;

(d) The co-operative system, formed by semi-public and private associations.

THE CENTRAL BANKING GROUP

The functions of central banking—handling of the treasury's funds, issue of legal tender notes, control over the foreign exchanges and the internal money market—were performed by a group of four public banks; namely, the Central Bank of China, the Bank of China, the Bank of Communications and the Farmers Bank of China—usually referred to as the four Government banks. The fact that four institutions were placed in official charge of these functions was due to the traditional privileges enjoyed by the Bank of China and the Bank of Communications, and to the political connections of the Farmers Bank of China. The intention of reorganizing the Central

Bank of China, to make it the only central institution, "holding the reserves of the banking system and acting as depository of all public funds, providing centralized rediscount facilities," was announced in a statement issued by the Minister of Finance, Dr. H. H. Kung, on November 3, 1935, but the outbreak of the Sino-Japanese War in July 1937 prevented it from being put into effect.

The Central Bank of China. The Central Bank of China was founded in Shanghai in October 1928, as "the State Bank of the Republic of China" (Art. 1 of the Charter of the Central Bank of China of 1928). The capital was fixed at CN$20 million, contributed entirely by the Government, and a provision was made for public distribution of its shares (Art 2). The internal organization of the bank consisted of two independent departments, banking and issue, each directed by a general manager (Art. 13). Its administration was entrusted to a board of nine directors, appointed by the National Government for a term of three years, but eligible for reappointment; three of them were chosen as representatives of industrial, commercial and banking interests. Five directors were designated as managing directors (Arts. 9, 14, 19). From among the directors the National Government selected and appointed a governor and a deputy governor (Art. 10). An auditing supervisory committee of seven members, representatives of industrial, commercial and banking interests and of the Auditing Office of the Government, was also appointed on two year terms by the National Government (Arts. 12, 15). Special rights were granted to the bank: issue of bank notes, minting and circulation of coins, depository and fiscal agency of the Treasury and agency of the Government in floating domestic and foreign loans and in undertaking the service of such loans (Art. 5). The bank was authorized to transact general banking business, with the exception of (a) loans on real estate; (b) purchase of bonds, stocks and debentures of any corporation or acceptance of them as security; (c) loans on merchandise; (d) direct interests in industrial and commercial undertakings; and (e) loans and advances without adequate security (Arts. 7, 8).

The charter was originally granted for a period of thirty years. The first two years of life of the institution were particularly difficult, as a consequence of the uncertain political

and military struggle of the National Government against provincial authorities. A run occurred in March 1929, but the bank was able to meet fully the redemption of its notes, and afterward its prestige and importance grew steadily. In the latter part of 1934 its capital was raised to CN$100 million, CN$15.8 million being transferred from the reserve account and the balance subscribed by the National Government.

At the same time, important changes were also made in the internal organization of the bank, and on May 23, 1935, a new Law governing the Central Bank of China was promulgated, chartering the institution for a new period of thirty years (Art. 5). Under this law, the institution was defined as "the Government Bank established by the National Government of the Republic of China" (Art. 1). The head office was located in the capital of the Republic of China (Art. 3). No provision was made as to the amount or type of shares, although it was stated that "shares of the capital may be offered to the public for subscription" up to a maximum of 40 per cent of the total capital and that "Chinese banking institutions shall have a preferential right" on three-fourths of the capital of the bank so subscribed (Art. 7). The profits of the bank were to be distributed as follows: 50 per cent to the reserve account, an unspecified percentage to the employees benefit fund and the balance to the National Treasury (Arts. 33, 34).

The charter placed the administration of the bank into the hands of a board of directors, consisting of eleven to fifteen members, appointed by the National Government for terms of three years and eligible for reappointment. At least three members were selected to represent industrial, commercial and banking interests, and five to seven members were designated as managing directors (Art. 8). No restriction was placed upon the choice of the governor and of the two deputy governors by the National Government; they were appointed for terms of three years and were made eligible for reappointment (Art. 9). The supervisory committee of seven members, appointed for two years, was maintained, and the agricultural, industrial, commercial and banking interests and the auditing department of the Government were represented there (Arts. 10, 13).

The internal organization of the bank was entrusted to the head office, and the operations were distributed among depart-

ments set up with the approval of the National Government (Arts. 14, 15). There were six such departments; namely, banking, issue, treasury, auditing, secretarial and economic research; the business of each department was distributed through divisions and sections. The establishment or abolition of a branch or foreign agency was made conditional upon approval of the board of directors, with the decision referred to the National Government for record. The appointment of departmental and branch managers was entrusted to the governor, with the concurrence of the board of directors.

The bank's functions included the right (a) to issue notes, which were to be "accepted at par" throughout the country and free from any tax on bank notes; (b) the right to act as fiscal agent of the National Government and of all state enterprises, and (c) the right to act as the Treasury's agent in the flotation of domestic and foreign loans and in undertaking the service of such loans (Arts. 17-27).

More detailed regulations were issued relating to banking operations. It was provided that the bank should be authorized:

(a) To discount bonds, Treasury notes, coupons, issued or guaranteed by the National Government with maturities not longer than six months from the date of discount or rediscount;
(b) To rediscount domestic bankers' acceptances, domestic trade bills of exchange and promissory notes, arising from the production, fabrication, transportation or sale of goods, with maturities not exceeding six months from the date of acquisition by the bank;
(c) To buy, sell, discount and rediscount drafts and bills of exchange payable abroad, arising from export and import trade, with maturities not exceeding four months from the date of acquisition by the bank.

It was required that the paper under (b) and (c) be guaranteed by at least two responsible endorsers; paper with the name of only one endorser could be rediscounted only if secured by bills of lading, warehouse receipts and other credit instruments giving the bank control over goods with a value at least 25 per cent above the face value of the credit instrument which they secured. The rate of rediscount was set by the board of directors upon recommendation of the governor; the rediscount rates of the various branches were adjusted on the basis of the local money market (Arts. 28, 29). All other general banking operations were permitted, and the institution

was authorized to act as a clearing house for other banks (Art. 28). The following restrictions, however, were imposed:

(a) Real estate could be acquired only in satisfaction of debts and had to be disposed of within one year;
(b) The period of loans was not allowed to exceed six months;
(c) The amount of loans to any individual, corporation or other private entity could not be in excess of CN$500,000 or of one third of the debtor's capital and reserves in the case of limited liability companies;
(d) Neither credit instruments for capital investments for the financing of commodities in the luxury class and for speculative operations, nor merchandise could be purchased or accepted as security for loans, although they could be accepted as additional security for commercial loans;
(e) Any direct participation in commercial and industrial enterprises, the granting of guarantees or the acceptance of credit instruments of a third party (other than the Government), loans and overdrafts on personal credit and business of a speculative character were strictly forbidden (Arts. 30, 31).

The charter of the Central Bank of China of 1935 was worded in strict terms only in those articles relating to the private business of the institution, and its value proved to be theoretical rather than practical. The regulations of the bank's operations as Treasury agent were most inadequate; for example, no specific provision was made for Government deposits and for advances to the Government. This fact was the result of the privileges granted to the other banks and a symptom of the difficulties inherent in the policy directed toward making the Central Bank of China the only Treasury agency. The lack of more rigid provisions in this field, and the existence of Government ownership and control, however, proved helpful in making possible rapid changes in the bank's policy, in accordance with the requirements of the Government's financial activities. The need for a concentration of efforts under Government direction, in opposition to a decentralization of responsibilities and independence of activities, was indeed emphasized by the Minister of Finance, Dr. T. V. Soong, in the Report for the fiscal year 1929-1930. From this close connection with the National Government, as well as from the outstanding personality of its first governor, Dr. T. V. Soong, the Central Bank of China derived strength and prestige.

The Bank of China. The Bank of China was reorganized

in November 1928, under a new charter granted by the National Government, which made it a special institution for international exchange. The head office of the bank was then transferred from Peiping to Shanghai and CN$5 million of new capital was subscribed by the Government, raising the total to CN$25 million. In 1930 its general manager, Chang Kai-ngau, made an extensive tour abroad, for the purpose of studying the banking systems of the leading commercial countries. Upon his return, considerable changes were made in the bank, the most important being the adoption of a public audit of the reserves against note issue, the establishment of a trust and a foreign department and the opening of agencies in London and Osaka. Special efforts were also made to increase the commercial business, but it was only after a second reorganization, in March 1935, and the opening of agencies in New York and Singapore in 1936, that the bank acquired a dominant position in the foreign exchange business.

With the reorganization of 1935 the capital of the bank was raised to CN$40 million, distributed into 400,000 shares, of which half was subscribed by the Government through delivery of bonds and the remainder held by private shareholders. (Art. 2, Charter of the Bank of China of 1928, as amended in 1935). The bank was organized as a limited liability company (Art. 1), with shares registered and issued only to shareholders of Chinese nationality (Art. 4). A reserve fund for the purpose of covering loss of capital and equalization of dividends was provided by an allocation of 19 per cent of the annual earnings; the net profits were to be distributed among dividends of 7 per cent on the private (preferred) stock, 5 per cent on the Government stock and a bonus to the shareholders (Arts. 7, 8).

Control of the bank was jointly exercised by the Ministry of Finance and by the general meetings of shareholders, attended by those shareholders holding or representing ten or more shares registered for a period of not less than 60 days (Arts. 15-18, 21). Every shareholder was entitled to one vote for every ten shares up to 100 shares and to one vote for every additional twenty shares (Art. 20). Only shareholders holding at least 100 shares were eligible to vote for the election of twelve of the twenty-one directors and four of the seven supervisors; the Ministry of Finance appointed the

additional nine directors and three supervisors. Seven directors were designated as managing directors, forming the board of directors; the chairman, nominated by the Ministry of Finance with the approval of the other directors, appointed a general manager (Arts. 13, 14). The Minister of Finance had the right to prohibit any action of the bank, if it were in violation of the charter or by-laws, or if detrimental to the policy of the Government (Art. 22), a rule which was modeled upon a provision of the Bank of Japan.[1]

The Bank of China maintained its right of note issue (Art. 10), and was "entrusted by the Government and by the Central Bank of China"[2] with matters relating to the issue and service of Government bonds on foreign markets, the handling and the administration of public funds abroad, the handling of a portion of the Treasury funds and the promotion and fostering of trade abroad (Art. 9). General banking business was authorized in Article 11, and Article 12 prohibited loans without security, loans on or purchase of its own shares, acquisition of real estate or direct participation in industrial and commercial enterprises. Limitations were much less defined in the case of the Bank of China than in the case of the Central Bank of China.

The purpose of the Government in drafting the new Charter was to make the Bank of China a special institution for international trade, as the Yokohama Specie Bank had been made in Japan. There was, however, an important difference; namely, the Bank of Japan did not handle foreign exchange or discount any paper arising from foreign trade. All these transactions passed through the Yokohama Specie Bank, which could obtain advances from the Bank of Japan and operated, in a sense, as the foreign department of the Bank of Japan.

[1] Article 24 of the Bank of Japan Act and Article 55 of the By-Laws of the Bank of Japan. By these provisions, the governor of the Bank of Japan was required to report to the Government any decision adopted by the administrative board, which he considered contrary to the Act, to the by-laws, or to the interest of the State.

[2] It is difficult to say what this really means. The Charter of the Bank of China was not granted by the Central Bank of China, nor did the Central Bank of China have any legal authority over the Bank of China. This paragraph was probably introduced to adjust the privilege granted to the Bank of China with Article 26 of the Law Governing the Central Bank of China, granting a vaguely expressed right to be the sole fiscal agent. See, for the same question, Article 9 of the Charter of the Bank of Communications.

On the contrary, relations between the Central Bank of China and the Bank of China were not clearly defined, and as a result, there was overlapping in their functions; a separation of functions between the two banks was never achieved.

The Bank of Communications. The Bank of Communications was reorganized in November 1928, under a charter which made it, "by special sanction of the National Government, a bank devoted to the purpose of fostering and developing the industries and trade of the whole country" (Art. 1). The head office was moved from Peiping to Shanghai, and an internal reorganization took place, with the opening of a trust and a savings department.

The capital was first fixed at CN$10 million, 20 per cent of which was contributed by the National Government. It was raised in March 1935 to CN$20 million through the delivery to the bank of CN$10 million in Government bonds. As embodied in the charter of the Bank of Communications of 1928 (amended in 1935), regulations regarding shares, allocation of profits, the board of directors, shareholders' rights and meetings and the authority of the Ministry of Finance were exactly the same as those of the Bank of China.

Like the Bank of China, the Bank of Communications was authorized to issue bank notes (Art. 10) and was permitted "upon authorization of the National Government and of the Central Bank of China, to transact the following business: (a) the underwriting and service of Government bonds and Treasury bills; (b) the issue and service of debentures for public industrial organizations; (c) the handling of part of the business of the Government Treasury; (d) the promotion and the development of other industrial enterprises" (Art. 9).[3] The bank was authorized to transact general banking business, to underwrite debentures issued by industrial firms, to make loans to industrial firms against reliable security such as movable

[3] There is a noticeable difference in the wording of Article 9 of the charter of the Bank of China and Article 9 of the charter of the Bank of Communications. The Bank of China "shall be entrusted," while the Bank of Communications "shall, upon authorization, transact," which gives a different legal standing to the two banks, the Bank of China being as a rule a fiscal agent, the Bank of Communications being such only when occasion requires it. In practice, however, this difference was not of great importance. Moreover, while the Bank of China was entrusted with the funds, the Bank of Communications "may" transact the business of the National Treasury. This difference also had no great importance in practice.

and immovable property and to handle the storage, transportation and insurance business. No limitations were placed upon its direct participation in commercial and industrial enterprises (Art. 11, 12). Loans on or purchases of its own shares, as well as loans without security, and acquisition of real estate were prohibited (Art. 12).

The Bank of Communications failed to develop along the lines of an industrial bank. The predominance of current accounts and the lack of a security market hampered its action, and its business continued to be restricted to commercial and industrial financing of existing enterprises and of the Government.

The Farmers Bank of China. The Farmers Bank of China was established in April 1933 as the Four Provinces Agricultural Bank, or Agricultural Bank of Hunan, Hupeh, Anwhei and Kiangsi. Its head office was located in Hankow, at that time headquarters of the National Army for the campaign against the Communists. The expansion of its branches closely followed the movements of the Army, from central China to the western, northwestern, southern and southwestern provinces; it opened a branch in Shanghai in 1935, but kept aloof from the other institutions.[4] The close ties between this bank and the highest personalities of the Army were the subject of rumors and gossip, but definite information was never made available.

On June 4, 1935 the Farmers Bank of China was reorganized under its present name with a new charter for thirty years (Art. 4). Its capital was fixed at CN$10 million, one quarter of which was subscribed by the National Government and the remainder by provincial authorities and private individuals of Chinese nationality (Arts. 2, 3). The bank handled short and intermediate term loans (i.e., loans having maturities from a few months to five years) to farmers for improvements and purchases of agricultural implements (Arts. 6-8). Lending was permitted on movable and real property; the latter was limited to 60 per cent of the value of the mortgage and its total could not exceed the amount of capital and reserves of the bank (Arts. 9, 10). Upon authorization of the Government, the bank was authorized to issue bonds up to

[4] For instance, the bank did not join the Shanghai Bankers Association, although its importance would have warranted this.

five times its capital or up to the total amount of its outstanding loans (Art. 12).

The management of the bank was entrusted to a board of fifteen directors, elected by the shareholders, with a standing committee composed of seven members. The president of the bank was appointed by the National Government, upon proposal of the chairman of the board (Arts. 14-17). A supervisory board of five members and regular shareholders' meetings were also provided for in the charter, as in the case of the Bank of China and the Bank of Communications (Arts. 18-23). Profits were distributed among reserves (20 per cent), dividends (40 per cent), bonuses, employees benefit fund and other special reserves (40 per cent).

Article 11 of the charter granted the right of note issue. Government regulations at first fixed the upper limit at CN$100 million for a period of two years. The new currency regulations of 1935 made no provision as to the status of these notes, but in February 1936 a Government order authorized the bank to take over the issuing privileges of provincial and local institutions and granted a status of legal tender to its notes, requiring at the same time that the bank deposit silver and foreign exchange reserves with the other three Government banks. In February 1937, a new order of the Ministry of Finance definitely recognized these notes as legal tender and instructed the bank: (a) to hand over the reserves to the Currency Reserve Board and report monthly as to the amount of notes issued and as to reserves; (b) to concentrate attention upon the circulation of its notes in rural districts and border areas, and (c) to co-operate with the Central Bank of China in the management of the foreign currency reserves.

RESOURCES AND OPERATIONS

In an analysis of their resources and operations, the four Government banks should be considered as a central banking group. Although their charters gave each of them special functions, the operations proper to central institutions—namely, foreign exchange, issue of bank notes, issue of Government bonds, holding of public funds, holding of note and banking reserves, rediscounts and advances in the money market and clearing for other banks—were scattered rather indiscriminately among the four banks. The banking reform of 1935, which

brought the Bank of China and the Bank of Communications under Government control, had the apparent purpose of obtaining closer co-operation between the four banks, through a co-ordination of operations and interlocked directorates.

Deposits. The expansion in the deposits of the Government banks from 1928 to 1936 is indicated in table 6.

TABLE 6

DEPOSITS OF THE CENTRAL BANKING GROUP
December 31, 1928–1936
(In millions of national yuan)

	Central Bank of China	Bank of China		Bank of Communications		Farmers Bank of China
	Total deposits	*Current accounts*	*Fixed accounts*	*Current accounts*	*Fixed accounts*	*Total deposits*
1928	15.5	335.5	52.4	103.4	46.6	..
1929	49.8	382.8	55.3	102.5	56.0	..
1930	76.2	465.7	69.7	120.3	52.4	..
1931	90.6	288.5	174.2	126.1	60.4	..
1932	168.5	241.9	234.4	142.1	70.0	..
1933	227.2	338.1	211.2	165.6	74.5	8.3
1934	249.5	294.8	251.9	179.6	107.1	15.6
1935	595.9	465.2	344.2	260.6	126.2	53.0
1936	713.8	559.4	504.9	348.1	191.2	155.4

Source: Annual Reports of the four banks.

The increase in deposits was not peculiar to the Government banks, but was a phenomenon common to all banking institutions. The rapid increase in fixed deposits after 1930 was partially a consequence of the concentration of idle funds in Shanghai. It represented a new factor in Chinese banks, which were traditionally the depository of liquid rather than fixed funds, and the bearing of this factor upon investment policy cannot be overlooked. The Bank of China and the Bank of Communications gained proportionately less than the Central Bank of China, due to the accumulation of Government deposits in the latter institution, and also less than the largest private banks. A partial explanation of this fact may be found in the precarious situation of the chain of branches which they maintained in Manchuria.[5]

[5] Prior to 1932, the Bank of China and the Bank of Communications commanded the greatest confidence among all Chinese banks in Manchuria. With the change in the political regime, the opening of the Central Bank of Manchou (1932), the promulgation of the new Banking Law (November 1934) and the introduction of the exchange control (November 1935), their position became extremely precarious. In 1934 there were three other Chinese

The proportion of deposits held for official account was disclosed only by the Bank of China, from 1933 to 1936. In 1933 Government deposits with the Bank of China amounted to CN$22.3 million or 4 per cent of total deposits; in the following years the figure rose steadily to CN$31.6 million in 1934 (5.8 per cent), to CN$41.3 million in 1935 (5.1 per cent) and to CN$72.0 million in 1936 (6.8 per cent). The Bank of China handled Government funds abroad, the Bank of Communications handled domestic funds of public enterprises and the Farmers Bank of China handled the funds of the National Army; all these banks acted as fiscal agents in localities where no branches of the Central Bank of China were established. At the end of 1936, the net of 211 branches of the Bank of China and 125 branches of the Bank of Communications was larger than the number of branches of the Central Bank of China (forty-five branches). The greatest portion of public funds, however, was handled by the Central Bank of China. In fact, the growth of its deposits proceeded with the expansion of the national budget from CN$434.4 million in 1928-1929 to CN$990.6 million in 1936-1937, with an accumulated cash balance amounting to CN$89.8 million as of the middle of 1935; the custom and salt revenues, which were entirely deposited at the Central Bank of China after 1932, increased from CN$200 million in 1928-1929 to CN$500 million-CN$600 million a year during the period from 1934 to 1936.

No information is available with regard to the extent to which the Central Bank of China and the Farmers Bank of China acted as reserve depositories for other banks. The item "Due to banks" in the Bank of China's statement appeared for the first time in 1931, amounting to CN$44.9 million, or 12.4 per cent of total deposits, and rose in 1936 to CN$162.0 million, or 15.3 per cent of total deposits. An item of CN$20.0 million, which regularly appeared in the statement of the Bank of Communications under "Due to other banks, loans from other banks," was apparently a residue of Nishihara loan transactions.

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banks in Manchukuo, with small business. Their total deposits shrank from M¥52.9 million on December 31, 1934 to M¥20.1 million on September 30, 1936. Central Bank of Manchou, *Manchukuo Business and Finance,* June and December 1936, and comment in Bank of Communications, *Annual Report,* 1935.

The Central Bank of China, the Bank of China and the Bank of Communications served as clearing institutions for the Clearing House of the Joint Reserve Board of the Shanghai Bankers Association; at the close of 1935 the deposits of the Board amounted to CN$115.1 million. This evidently accounted for the largest part of bankers' deposits in the three Government banks, the balance probably formed by interbank balances outstanding among the four banks themselves and by deposits of the native banks and of modern banks not belonging to the clearing house. These banks were obliged to maintain funds with a clearing bank in order to settle their accounts with other modern banks or foreign banks. Foreign banks, however, were allowed to draw upon the Bank of China for clearing purposes without maintaining active balances.

Private deposits were maintained with the Government banks by two classes of depositors; namely, (a) individuals and institutions and (b) industrial and commercial enterprises. No information is available with regard to the amount outstanding at the Central Bank of China, although it is known that the maintenance of current accounts in Customs Gold Units after 1930 became a general practice of importers, who could draw checks to meet payments of customs duties in this currency. In the case of the Bank of China, balances of industrial and commercial enterprises amounted to about one fifth of total deposits. No data are available for the Bank of Communications and the Farmers Bank of China; the latter held considerable deposits of semi-public institutions such as agricultural cooperatives.

A very low interest rate, if any, was paid on the Government deposits, especially on those kept at the Central Bank of China. On other deposits, however, current rates were paid, ranging from 2 per cent on current accounts to 8 or 9½ per cent on fixed and savings deposits.

The importance of the four Government banks as the depository of the country's banking resources may be better judged by the fact that at the close of 1935 (the last date for which complete statistics were made available) they had 40 per cent of total capital and reserves and 56 per cent of total deposits of all modern banks. It is evident that with the backing of the Government and with the note issue privilege, in addi-

tion to the most extensive chain of branches and the sizable amount of funds obtained from other banks, these institutions were placed in an especially favorable position and served as a connecting medium between Government and money market, thus representing a decisive factor in the determination of the financial policy.

Earning Assets. The earning assets covering these liabilities of the central banking group may be classified under two main items; namely, (a) loans, discounts and overdrafts and (b) investments in securities. Their growth proceeded with the increase in the deposits, and is shown in table 7.

TABLE 7

EARNING ASSETS OF THE CENTRAL BANKING GROUP

December 31, 1928–1936

(In millions of national yuan)

	Central Bank of China		Bank of China		Bank of Communications		Farmers Bank of China	
	Loans, discounts, overdrafts	*Investments*	*Loans, discounts, overdrafts*	*Investments*	*Loans, discounts, overdrafts*	*Investments*	*Loans, discounts, overdrafts*	*Investments*
1928	4.5	10.0	359.2	32.7*	120.6	8.6	..	..
1929	15.3	8.5	410.2	33.2	121.9	8.9	..	..
1930	28.3	.8	472.8	65.1	134.2	13.2	..	..
1931	75.0	..	333.9	72.1	138.8	19.4	..	..
1932	97.7	.3	322.8	64.5	145.5	26.0	..	..
1933	142.8	.2	351.3	32.1	158.6	30.0	6.2	.3
1934	85.2	155.4	442.0	25.4	198.3	29.3	11.4	.7
1935	164.3	252.9	509.6	41.9	135.0	50.6	35.1	10.0
1936	487.5	37.6	767.5	45.2	380.9	64.0	78.2	3.5

Source: Annual Reports of the four banks.

There is no detailed information regarding advances of the four banks to the Government. In the annual reports of the Ministry of Finance the accumulated balances of bank loans and overdrafts obtained by the Government was reported at CN$390 million as of June 30, 1935. On that same date, outstanding loans of the Bank of China to the Government amounted to about CN$100 million aside from CN$10.7 million in loans to provincial authorities. Relatively small amounts were probably lent by the Bank of Communications and the Farmers Bank of China; the largest portion was undoubtedly advanced by the Central Bank of China.

Although loans to and deposits with banks were an important item, a large portion consisted of inter-bank balances outstanding among the four banks themselves. In the statement of the Central Bank of China, the item "cash on call with

banks" rose steadily from CN$10 million in 1928 to CN$225 million in 1936. In the case of the Bank of China, various credits to and cash deposited with other banks averaged about CN$130 million during the 1936-1937 period. No information is available for the Bank of Communications and the Farmers Bank of China; the former, however, joined the other two institutions in making special advances to commercial banks during 1935. Direct loans to other banking institutions represented a necessary operation of intervention in a money market where no rediscount existed. In 1936, bills in the hands of the Bank of China totaled CN$45.2 million, and those discounted and purchased by the Bank of Communications amounted to CN$13.7 million. Prior to 1933 the Bank of China acted as a rediscount institution for the native banks, but afterward it adopted a policy of purchasing bills directly in the open market.

In the middle of 1935, approximately two fifths of the paper in the hands of the Bank of China covered foreign transactions; its bills of exchange were about 70 per cent larger than in 1934, and a marked increase was also noticeable in foreign letters of credit, remittances, drafts and promissory notes. The Bank of China endeavored to develop its operations in foreign exchange, in order to bring the international value of the national yuan under its control. In the middle of 1935, the bank had exchange contracts receivable amounting to CN$140.6 million and packing credits outstanding for CN$1.2 million. It is impossible to estimate the value of foreign exchange transactions done by the bank for its own business requirements and the amount which served to cover exchange operations done by other banks. It is believed, however, that foreign exchange passing through the hands of the Bank of China increased further during 1936, when holdings of dollars and pounds were expanded through the liquidation of silver and the financing of the Government-monopolized export trade. Unofficial estimates placed the foreign exchange business controlled by the Bank of China in 1936-1937 at 40 to 60 per cent of the total foreign exchange business done by all modern banks, which probably was larger than that transacted by foreign banks. The Central Bank of China handled foreign exchange in connection with the official control of rates; the amount and kind of transactions made by the Bank of Com-

munications and the Farmers Bank of China were unknown, but their importance was limited.

Domestic loans and overdrafts by the four banks were granted for commercial, industrial and other purposes, at interest rates starting at 6 per cent. The Bank of China, the Bank of Communications and the Farmers Bank of China, which were permitted to lend money on merchandise, established their own go-downs (warehouses), where agricultural and other goods were received as security for loans. Commercial and industrial enterprises obtained the largest share, with cotton, flour, silk, cigarette and oil businesses as the chief customers. The commercial and industrial credit granted by the Bank of China during 1935-36 amounted to around CN$200 million. The total of agricultural credits granted on the security of goods deposited in warehouses and those to co-operative societies amounted to CN$25 million-CN$30 million. The balance of the loans by the Bank of China, involving some CN$200 million, included loans to communications and public utilities enterprises, private business firms and individuals. No information on domestic financing was made available by the other three banks.

Securities were owned by the banks not only as investments, but also as reserves against notes in circulation. Before 1934 the Central Bank of China reported all its investments as "Government securities." In 1935 the term "Government" was dropped, but undoubtedly Government obligations and Government-guaranteed bonds continued to constitute the bulk of securities in the vaults of the four banks. There is no evidence of any deliberate open market policy pursued by the institutions. The large increase after 1933 in the holdings of the Central Bank of China was due to the needs of the Treasury during a period of tight credit conditions. By the end of 1936 the bank had presumably disposed of about all the securities acquired, partially by transfer from the portfolio account to the security reserve against notes. Beginning in 1931, the Bank of China adopted a policy of buying Chinese foreign exchange bonds, the amount of which rose to about one fourth of its total investments in 1935-36. All four banks subscribed in considerable amounts to provincial issues authorized by the National Government.

Securities held as reserve against notes in circulation

amounted to CN$440 million at the close of 1936. At that date, securities in the hands of the Government banks as investments and reserves totaled CN$590 million. This figure represented only a relatively small percentage of the total Chinese national debt, internal and external, which was estimated on the same date at CN$3,000 million by E. Kann and at CN$6,000 million by the National People's Economic Planning Committee of the Executive Yuan; however, it represented about one third of China's internal debt, which was reported at CN$1,800 million.

Distribution of Assets and Liabilities. An estimated distribution of assets and liabilities of the four banks in 1934-1936 is given in table 8.

TABLE 8

AVERAGE ASSETS AND LIABILITIES OF THE CENTRAL BANKING GROUP

1934–1936

(In percentages of total liabilities/assets)

	Bank of China	Central Bank of China	Bank of Communications	Farmers Bank of China
ASSETS				
Loans, discounts, overdrafts—to	55	36	43	43
Government	*20*	+	−	+
Banks	*3*	+	−	−
Business firms	*17*	−	−	−
Industries and public utilities	*10*	−	+	−
Agriculture	*3*	−	−	+
Others	*2*	−	−	−
Investments	4	22	8	4
Cash on hand	25	32	26	45
Other assets	16	10	23	8
LIABILITIES				
Capital and reserves	4	15	5	7
Total deposits—by	78	76	85	83
Government	*5*	+	−	+
Banks	*16*	−	−	−
Business firms	*9*	−	+	−
Private	*48*	−	+	−
Others	18	9	10	10

Note: The percentages have been estimated upon the yearly average figures of assets/liabilities (excluding reserves against note issue and bank notes in circulation) of the four Government banks for the years 1934 to 1936. The detailed percentages of the Bank of China (estimated on the basis of information contained in its Annual Reports) have been taken as standard to indicate the importance of each item in the other banks. The marks + and − indicate that the percentage of the item was believed to be higher or lower, respectively, than the percentage of the equivalent item in the Bank of China.

TABLE 9

ASSETS AND LIABILITIES OF THE CENTRAL BANKING GROUP

December 31, 1928, 1930 and 1932–1936

(In thousands of national yuan)

	1928	*1930*	*1932*	*1933*	*1934*	*1935*	*1936*
Assets							
Cash on hand	38,502	47,628	132,735	133,453	90,805	158,960	581,529
Loans, discounts, overdrafts	522,826	715,838	790,984	1,052,880	1,120,903	1,791,358	2,141,933
Investments	51,152	79,100	90,908	62,415	210,779	352,036	150,461
Bank premises	11,955	17,371	19,091	12,951	22,504	26,874	38,480
Other assets	250	2,450	28,030	41,611	50,040	55,416	91,044
Reserves against notes in circulation	152,043	309,410	318,923	349,803	408,938	676,841	1,270,221
Liabilities							
Paid-up capital	53,425	53,425	53,427	55,928	136,716	167,116	167,203
Reserve funds	10,710	10,292	17,243	25,838	14,377	16,160	23,878
Deposits	554,152	785,251	940,075	1,156,443	1,266,896	2,106,259	2,673,144
Drafts issued	6,341	6,502	9,231	9,875	12,257	33,486	40,119
Other liabilities	..	1,423	27,510	41,450	46,826	47,086	77,108
Net profits	57	5,494	14,262	13,776	17,959	14,537	21,998
Notes in circulation	152,043	309,410	318,923	349,803	408,938	676,841	1,270,221
Total Assets/Liabilities	776,728	1,171,797	1,380,671	1,653,113	1,903,969	3,061,485	4,273,668

Note: The combined balance sheets of the modern banking groups (central banks, provincial and municipal banks, commercial banks, savings banks and special banks) have been compiled according to the statistical tabulation set up by the Research Department of the Bank of China in *The Chinese Bankers Yearbook.* The following list is indicative of, but does not cover fully, the items of the statements of the various banks included in the combined balance sheets:

Assets:

Cash on hand—Cash on hand; Cash on hand and in transit; Cash on hand and with banks.
Loans, discounts and overdrafts—Loans, discounts and overdrafts; Cash on call with banks; Due from banks; Fixed loans; Bills discounted and bought; Accrued items and items receivable; Bills for collection; Forward contracts bought.
Investments—Investments; Securities; Bonds and stocks.
Bank premises—Bank premises; Furniture and fixtures; Land and buildings; Real estate; Preliminary expenses; Cost of printing notes.
Other assets—Other assets; Engagements account; Liabilities of customers.
Net losses—Net loss for the year.
Reserves against notes in circulation—Reserves against notes in circulation; Reserves for bank notes issued.
Reserves against notes issued for account of other banks—Reserves against notes issued for account of other banks; Reserves for other bank notes issued; Reserves for bank notes issued through us.

Liabilities:

Paid-up capital—Paid-up capital; Capital (less capital uncalled).
Reserve funds—Statutory reserves; General reserves; Undivided surplus or profits; Reserves against losses; Reserve against bad debts.
Deposits—Current deposits; Current and other accounts; Fixed deposits; Savings deposits; Due to banks; Accrued items and accounts payable; Bills received for collection; Forward contracts sold; Unclaimed dividends; Bank orders outstanding.
Drafts issued—Drafts issued; Drafts payable; Remittances.
Net profits—Net profit for the year.
Other liabilities—Other liabilities; Engagements account; Liabilities of bank.
Notes in circulation—Notes in circulation; Bank notes issue account; Bank notes issued.
Notes issued for account of other banks—Notes issued for account of other banks; Other bank notes issued through us.

Source: Annual Reports of the Central Bank of China, the Bank of China, the Bank of Communications and the Farmers Bank of China.

The purpose of this tabulation is to summarize statistically the operations described above; owing to the lack of more extensive information, its value is necessarily limited. Moreover, the situation in 1934-37 cannot be taken as normal, because China was then coming out of a most serious deflation. However, operations in connection with the Government or with other banks were predominant, and loans and overdrafts to the Government and to other banks were much larger than the deposits received from them. No judgment can be made as to the internal liquidity of the institutions, although the principles of external liquidity, with special regard to cash on hand, were apparently observed. This liquidity also increased more rapidly than the average increase in bank operations, as indicated in Table 9. The real expansion in investments was obscured by the fact that amounts of Government bonds were shifted from the bank portfolios to the reserves against notes in circulation. Similarly, the slower expansion in bank reserves was due to the transfer, in 1934, of CN$15 million from the reserve account to the capital account of the Central Bank of China.

Note Issue and Monetary Policy. The four Government banks were granted the right of legal tender issue; a comparison of their circulation and silver stocks is shown in Table 10.

TABLE 10

NOTE CIRCULATION AND SILVER STOCKS OF THE CENTRAL BANKING GROUP

December 31, 1928–1935

(In thousands of national yuan)

	Central Bank of China		Bank of China		Bank of Communications		Farmers Bank of China	
	Circulation	*Silver*	*Circulation*	*Silver*	*Circulation*	*Silver*	*Circulation*	*Silver*
1928........	11,713	11,527	172,304	52,006	68,026	16,884	..	..
1929........	15,380	32,291	197,728	58,099	69,222	18,042	..	..
1930........	22,669	36,496	203,847	68,676	82,894	17,790	..	..
1931........	25,173	34,658	191,749	44,781	81,098	22,677	..	..
1932........	39,995	40,318	184,426	98,509	82,425	33,514	..	..
1933........	71,063	77,455	183,727	86,269	83,111	26,434	2,008	2,008
1934........	86,048	106,448	204,713	68,641	112,512	47,000	5,633	5,633
1935*.......	131,828	81,390	185,503	81,430	122,000	49,500	29,847	29,847
1935........	179,924	79,445	286,245	79,445	180,826	20,254	29,771	29,771
1936†.......	314,353	35,364	377,768	29,425	217,110	15,848	108,503	75,236

* Data as of November 6, 1935.

† Data as of September 30, 1936, last published figure of silver holdings of the banks.

The "Circulation" consists of national yuan notes, subsidiary currency and Customs Gold Unit notes as published by the four banks. The figures of silver holdings in the bank's offices, where notes were redeemable, were obtained from the *Financial and Commercial Monthly Bulletin* of the Bank of China.

Before 1933, notes were issued on the basis of the silver yuan coin minted according to the Regulations of 1914.[6] In March 1933 a new monetary unit, the standard yuan, was introduced, weighing 26.6971 grams and with a fineness of 88 per cent silver and 12 per cent copper. Before 1935, the law provided that notes should be secured by a cash reserve of silver bullion and coins amounting to at least 60 per cent of total issue and by Government bonds covering the balance. No limits were fixed as to the amount of notes issued, although a tax was levied. Subsidiary notes were issued only up to a fixed maximum amount. The Central Bank of China also issued special notes, based on an accounting gold currency, the Customs Gold Unit, which was introduced in 1930 on the basis of a hypothetically pure gold content of 60.1866 centigrams; gold coins were never actually minted, however. The exchange of the Customs Gold Unit into silver bank notes was fixed before March 1934 on the T/T (telegraphic transfer) Shanghai rate on New York and thereafter on the London rate of gold ingots of the previous day and the T/T rate on London. The buying and selling of Customs Gold Units became a general practice, and importers found it convenient to keep current accounts with the Central Bank of China and to pay duties by checks drawn on these accounts. This procedure actually hindered the issue of Customs Gold Unit notes, and the amount in actual circulation always remained rather insignificant. At the beginning (May-July 1931) the amount of notes in Customs Gold Units in circulation was around CGU 1 million; it declined to CGU250,000 by the end of the year and in 1936-37 it fluctuated around CGU375,000-CGU475,000. The law required that these Customs Gold Unit notes be covered by a 100 per cent cash reserve. This reserve was to be in silver before November 1935, and in silver and foreign exchange afterward.

As long as China was on a silver standard, the appreciation and depreciation of her currency were directly influenced by the upward and downward movements of the price of silver in London. The foreign banks manipulated the exchanges through arbitrage operations, and little, if any, conscious and effective effort for a monetary policy was exercised by the

[6] This silver yuan weighed 27 grams, and had a fineness of 88 per cent. Kann, E., *The Currencies of China*, Shanghai, 1927, p. 159.

Government banks before 1934. Up to that time the four banks limited themselves to a most conservative policy of currency management; consequently, their notes gained the confidence of the people and were freely circulated at par with silver. The occasion for active steps was offered by the rise of silver prices during 1934 and 1935. The Central Bank of China endeavored at first to bring the exchange of silver yuan under control by the official fixing of the Customs Gold Unit's foreign exchange rate and by curtailing arbitrage operations on the Shanghai Gold Stock Exchange. In September 1934 the National Government issued regulations limiting the transactions in foreign exchanges to "legitimate and normal business and personal requirements," but the order remained ineffective. In the following October, the Central Bank of China, with the co-operation of the Bank of China and the Bank of Communications, was empowered to fix a daily official rate of exchange, independent of the fluctuations in the external price of silver. This was to be offset by an export duty of 10 per cent and an equalization charge on the export of the white metal. In the words of T. V. Soong,

> The measure, while effective temporarily in preventing a further fall in commodities prices, eventually placed the country on the horns of a dilemma. If exchange rates moved up in sympathy with the rise in the value of silver, the export trade would be handicapped, and internal deflation continue. If on the other hand, exchange rates fell substantially, it would increase the difference between the internal and the external value of the currency, and a large scale continuous smuggling would ensue. As bank notes were then redeemable in silver, such a loss of confidence might easily lead to runs on the banks, with ruinous financial consequences.[7]

The logical solution of this problem was a middle course. The rise in the foreign exchange was partially checked, the upward movement of the exchanges on London reaching 1s. 8.1875d. in May 1935 from 1s. 5.150d. in October 1934, while the theoretical parity based on the silver prices was 2s. 3.850d. in the same month. The equalization charges, however, proved to be inelastic, and were not altered after April 1935, with the result that the spread between the theoretical parity based on the London price of silver and the market exchange

[7] Bank of China, *Annual Report,* 1935.

rate, plus export duty and equalization charge, rose from 0.1 per cent in March to 14.6 per cent in October 1935.[8]

Moreover, feelings of apprehension with regard to further currency developments resulted in considerably lower rates for forward exchanges, and the discount of forward upon spot rates rose to as much as 30 per cent per annum. Runs occurred in Peiping and Tientsin, where the banks of issue were forced to place undeclared but effective restrictions on the redemption of notes. At the end of August 1935, fresh rumors led to an extensive flight of capital, and by the middle of October 1935, after the Ministry of Finance issued a statement on the currency situation, the exchange on London dropped from 1s. 6.260d. to 1s. 2.750d. and the price of gold bars advanced from CN$900 to CN$1,160. On November 3, 1935 the National Government issued the decrees for the currency reform.

These decrees provided for the nationalization of all silver in circulation, against payment of legal tender notes issued solely by the Central Bank of China, the Bank of China and the Bank of Communications. Bank notes issued by other banks were to be gradually retired and exchanged for Central Bank of China notes. Reserves against legal tender notes were concentrated under the control of a newly established Currency Reserve Board, composed of:

(a) Five representatives of the Ministry of Finance (only one Special Commissioner was actually appointed);
(b) Two representatives each from the Central Bank of China, the Bank of China and the Bank of Communications;
(c) Two representatives each from the Shanghai Bankers Association and the Native Banks Clearing Association;
(d) Two representatives from the Chamber of Commerce;
(e) Five representatives from the various banks of issue, designated by the Ministry of Finance.

The executive work was entrusted to a standing committee of five to seven members, presided over by Dr. T. V. Soong, chairman of the Bank of China. The ex-officio chairman of the board was the Minister of Finance and governor of the Central Bank of China. Dr. H. H. Kung held these positions. The reserves were actually deposited with the three Government banks, the apportionment being decided upon by the Board

[8] Lin, W. Y., *The New Monetary System of China,* Shanghai, 1936, pp. 17-18, 70.

and reported to the Ministry of Finance for record. As a matter of political expediency rather than of actual necessity, regional branch boards were set up in Tientsin, Hankow, Canton, Tsinan, Tsingtao and Sian. The reserve requirements were fixed at 60 per cent cash, gold, silver and/or foreign exchange, and 40 per cent securities issued or guaranteed by the Government, and/or other assets acceptable to the Ministry of Finance, and/or acceptable short term commercial paper. A change was made in May 1936, by which the silver portion of the reserves was fixed at a value equivalent to not less than 25 per cent of the note circulation. To complete the work of internal reform, it was decided that "for the purpose of keeping the exchange value of the Chinese yuan at its present level, the Central Bank of China, the Bank of China and the Bank of Communications should buy and sell foreign exchange in unlimited quantities."

It is interesting to note that no provision was made for the circulation of the notes of the Farmers Bank of China. This bank had been granted the right of note issue by Article 11 of its charter of 1935 and by a Government regulation, which fixed the maximum of its outstanding notes at CN$100 million and limited their legal tender validity to two years. In February 1936 a Government order authorized the bank to take over the note issue privileges of provincial and local banks; the status of legal tender was granted to the notes of the Farmers Bank of China, which was called upon to deposit its reserves with the other three Government banks. In the opinion of China's monetary experts, however, this Government order could not have amended the currency regulations of 1935, and therefore the privilege of legal tender continued to be granted solely to the notes of the three other banks; moreover, the transfer of the reserves was never carried out.

The position of the Farmers Bank of China as a bank of issue was finally clarified in February 1937. A new order of the Ministry of Finance definitely recognized the legal tender status of the notes of the Farmers Bank of China and instructed the bank: (a) to hand over the reserves to the Currency Reserve Board and to make monthly reports as to the amount of notes and reserves outstanding; (b) to concentrate its attention upon the circulation of its notes in rural districts and border

areas, and (c) to co-operate with the Central Bank of China in the management of the foreign currency reserves.

The changes in monetary issues and reserves of the four Government banks after the currency reform may be seen in Table 11.

TABLE 11

NOTES AND CASH RESERVES OF THE CENTRAL BANKING GROUP

November 1935–June 1937

(In thousands of national yuan)

	Central Bank of China		Bank of China		Bank of Communications		Farmers Bank of China	
	Notes	*Cash reserves*	*Notes*	*Cash reserves*	*Notes*	*Cash reserves*	*Notes*	*Cash reserves*
1935								
November	152,221	100,935	248,636	90,240	143,432	41,923	29,847	29,847
December	176,065	118,257	286,245	201,152	176,245	113,409	29,771	29,771
1936								
March	252,349	169,617	310,151	235,176	186,698	129,279	34,777	34,777
June	300,099	202,727	351,773	232,063	204,912	143,189	92,035	64,127
September	314,353	212,192	377,768	238,375	217,110	151,943	108,503	75,236
December	326,510	213,156	459,310	283,510	295,045	179,423	162,014	127,897
1937								
March	361,835	235,038	501,404	316,208	308,577	189,298	200,053	168,384
June	375,840	243,558	509,863	315,227	313,548	191,841	207,951	165,892

Source: Reports of the Currency Reserve Board.

The expansion of the notes of the Government banks was offset to a great extent by the withdrawal both of notes issued by other banks and of silver coins. In November 1935 notes issued by seven commercial Shanghai banks amounted to CN$182.8 million; by the end of June 1937, they were estimated at CN$70 million. Notes issued by other banks (Shanghai banks excluded) amounted to only CN$100 million at the close of 1935.[9] Local readjustments of provincial issues (Szechwan, Yunnan, Kwangsi and Kwangtung) were under way in 1935 and 1936. The result was that by the middle of 1936 the percentage of legal tender notes (i.e., notes issued by the four Government banks) to the total currency in circulation ranged from a minimum of 2 per cent in Kwangsi to a maximum of 92 per cent in Fukien and 83 per cent in western Szechwan; the national currency was in circulation in all provinces.

The nationalization of silver made it necessary that paper notes be substituted for silver coins. By the middle of 1936

[9] According to the *Chinese Bankers Yearbook*, the note issue of Chinese banks, other than the Shanghai Banks amounted to CN$98.2 million on December 31, 1935. A few banks were excluded, such as the Hopei Provincial Bank, whose statement was not published; its note issue in October 1935 was reported at only CN$3.5 million.

the Currency Reserve Board had acquired about CN$225 million in silver coins and bars, in addition to the amount already held by the Government banks,[10] while the total value of coins handed over to banks and other collecting agencies (pawnshops, post offices, railway and steamship offices and public bureaus) was estimated by the Postal Remittances and Savings Banks at more than CN$300 million. This silver was paid for in national currency, and a premium of 20 per cent was usually granted.[11] Moreover, Chinese and foreign banks delivered their silver holdings (in Shanghai amounting to about CN$92.9 million, Japanese banks being excluded) in exchange for national currency at a ratio of 60 per cent in silver and 40 per cent in Government bonds. Everything considered, it seems that new note issues were closely related to the monetary reform, and that the increase in the circulation of the notes of the Government banks was due mainly to an expanding use of the national currency in substitution for other bank notes and silver coins. There was no evidence, therefore, of any inflationary action by the Government banks during the period 1935-1937.

Foreign Exchange Administration. The currency policy pursued after November 3, 1935 by the Government banks, and particularly by the Central Bank of China and the Bank of China, was directed toward introducing a mixed monetary standard, based upon a reserve of 25 per cent in silver, 35 per cent in foreign currency and the balance in Government bonds; the foreign exchange rates were fixed according to the London-New York cross-rate. Between November 1935 and June 1937 the total recorded export of silver from China amounted to CN$338 million, all of which probably was for the account of the Government banks.[12] The silver imported into the United States from China between December 1935

[10] Ministry of Finance, *Report for the Fiscal Year 1934-1935,* Nanking, 1936. In 1935 the Government banks expected to mobilize about one billion ounces of silver (CN$1,200 million in silver coins). Probably the quantity actually obtained between 1935 and 1938 was below these expectations—possibly 750 million ounces.

[11] A premium of 20 per cent was paid officially in Kwangtung, but rumors persisted that a similar premium was paid in other places. *Finance and Commerce,* December 9, 1935.

[12] The export tax and the equalization charge on the export of silver from China were raised on November 4, 1935 to the prohibitive rate of 67.75 per cent. Moreover, special permission was required for shipment of silver by persons other than the Government banks.

and July 1937 amounted to $75.6 million, which, at the rate of $29.75 to CN$100, gives an import value equivalent to CN$254 million.

Two agreements were reached with regard to silver by the Ministry of Finance of China and the Treasury Department of the United States. In November 1935 negotiations were completed for the sale of 50 million ounces of silver at the prevailing world price, or $30.5 million (CN$105 million) at $0.65 per ounce. In May 1936 a Chinese Bankers Commission headed by K. P. Chen visited the United States and made arrangements for the sale of "further substantial amounts of silver and also to make available dollar exchange for currency stabilization purposes." The sales of silver were scheduled to be made monthly, but as a consequence of the political situation, shipments were anticipated and completed by the end of 1936.[13]

The Bank of China, which already had an office in London, opened an agency in New York for the purpose of handling the business connected with exchange stabilization. It should be emphasized that, with a view toward maintaining exchange stability, the Government banks relied not upon administrative restrictions, but upon financial manipulations and market interventions. The importance of the operations of the Government banks was, therefore, paramount; the sale of silver provided the banks with the foreign exchange funds required for their monetary maneuvers.

An important consequence of the liquidation of the metal reserve was that, for the first time in history, the Chinese currency was no longer dependent upon the fluctuations of silver. In fact, should the price of silver rise, there would be no effect on the paper notes issued by the banks, since the notes were not redeemable in silver, although the metal reserve position would evidently have been strengthened. On the other hand, should the price of silver drop, the only effect upon the currency was indirect, i.e., a decline in the foreign exchange value of the metal reserve which could have had some psychological reaction on the market. But with the continuous liquidation of silver, the foreign exchange reserve became increasingly

[13] Ministry of Finance, *Report for the Fiscal Year 1934-1935*. Rumors of adoption of a gold standard and of loans from the United States to China circulated on that occasion.

more important than the metal reserve, and changes in silver prices were likely to have no significant influence upon the total reserve.

Through these operations, the national yuan was made a managed foreign exchange currency after 1935. The Chinese authorities took great care in emphasizing that neither the dollar nor sterling was the official standard of the Chinese currency.[14] On November 4, 1935, the T/T rates of Shanghai on the foreign markets were fixed on the New York-London cross-rates. The Central Bank of China's sterling selling rate of 1s. 2.725d. and the dollar buying rate of \$.30 were based on a cross-rate of \$5.00869 = £1; the sterling buying rate of 1s. 2.725d. and the dollar selling rate of \$0.29500 were based according to a cross-rate of \$4.84102 = £1. The spread between the two cross-rates allowed the national yuan to fluctuate in terms of the dollar widely enough, as long as sterling and the dollar maintained a fairly stable relationship. The yuan rates for sterling remained stable until September 1936, but adjustments with respect to the dollar were required on two occasions in February 1936. After September 1936 a more definite policy was followed. On September 9 the New York-London cross-rate rose to \$5.0524 = £1; a fact which called for an alteration of one of the official rates (either sterling or dollar) if arbitrage operations were to be prevented. The lowering of the sterling rate was liable to be interpreted as a weakening of the national yuan, while the raising of the dollar quotation would have given rise to the belief that China was a member of the sterling bloc. The Central Bank of China resolved the dilemma, by leaving the official rates unchanged and by doubling the spread between the buying and selling rates of dollar and sterling. It was evident, however, that such methods could hold only so long as the New York-London rates fluctuated within narrow ranges and the national yuan was not under extreme pressure. During the period from the end of 1935 to the middle of 1937, the Central Bank of China was required to supply large sums in foreign exchange on three occasions;

[14] See particularly the statement issued by the Minister of Finance, Dr. H. H. Kung, on May 17, 1936, in connection with the China-United States agreement, in which he defined the Chinese currency as "an independent currency, not linked to any other foreign monetary unit." *The China Quarterly*, Summer 1936, p. 137, and Chen Chin-tao, "The Finishing Touches of our Currency," *The Central Bank of China Bulletin*, June 1936, pp. 1-10.

namely in December 1935 (at the beginning of the new monetary system), in May 1936 (political crisis in southern China) and in December 1936 (kidnaping of Generalissimo Chiang Kai-shek). In each case the Central Bank of China had no hesitation in promptly meeting all demands for foreign exchange at the official rate, thus maintaining and enhancing the confidence of the people in the new currency.

A final word about the rate of stabilization chosen. As T. V. Soong pointed out, "It was the average rate of exchange for the yuan for the five years from 1930 to 1934, before outside influences appeared to force up the level of China's exchange. It would be most unwise to attempt to stabilize exchange at an unnatural level."[15]

Conclusion. In conclusion, it may be said that with the bank reorganization and the currency reform of 1935 the four Government banks were brought under direct Government control and their currency operations greatly unified. The process of centralization of control was at a most favorable point at the middle of 1937. In their position as central institutions, the banks were handling Government funds, making advances to the Government in the form of loans and overdrafts and distributing issues of Government bonds and Treasury notes. An open market policy, however, was not possible, due chiefly to the slow development of a normal market for securities.[16] Operations in the money market were made in periods of emergency, as a means of relieving credit stringency. Loans were granted to other banks against various types of securities; rediscount operations, however, could not be developed, due to the scarcity of paper and the reluctance of merchants and bankers to circulate whatever was in existence. Deposits from other banks, for clearing and other purposes, increased considerably after 1933.

The unification of the administration of the reserves against note issue and their transformation from silver into foreign exchange were the outstanding features of the National Government's policy, which was designed to build an independent national banking system and to nationalize the control of

[15] Statement to press on November 4, 1935, reprinted in *Chinese Economic Bulletin*, November 16, 1935.

[16] Marketing of Government securities was mostly speculative. Operations for an orderly marketing of such bonds were mentioned by the Bank of Communications, *Annual Report*, 1935.

foreign exchange. In this field, foreign assistance was a positive element. Great Britain co-operated through the monetary reform of Hongkong and by enforcing upon British nationals in China restrictions in accordance with the Chinese monetary laws. The United States contributed through the adjustments in its silver policy at the end of 1935, by which the silver price was permitted to decline and was then stabilized at a lower level thus discouraging smuggling of silver out of China; at the same time, new purchases of silver by the United States Government were made by direct agreements with the National Government of China, rather than in the open market. The friendly assistance of Great Britain and the United States was a most important element in the success of the monetary reform of China.

THE LOCAL OFFICIAL BANKING GROUP

As a consequence of the traditional political decentralization, banking institutions established by local (provincial and municipal) authorities always flourished in China. Their dependence upon the Ministry of Finance (with which they were legally required to register) varied with the degree of political control which the National Government exercised over the local authorities.

Provincial Banks. There were eighteen provincial banks in existence in 1936, in the provinces of Anhwei, Chekiang, Fukien, Honan, Hopei, Hunan, Hupeh, Kiangsi, Kiangsu, Kwangsi, Kwangtung, Ninghsia, Shansi, Shantung, Shensi, Sinkiang, Szechwan and Yunnan. They all had been reorganized or established after the National Government came into power in 1927. Public information on these banks was most unsatisfactory: in 1935 three banks, the Hopei, the New Fu-Tien (Yunnan) and the Sinkiang, published no statements of their condition; the others issued disparate statements and gave no satisfactory evidence of their business.

A capital of 2 million to 4 million yuan (national or local) was usual, with 1 million yuan as minimum and 10 million yuan as maximum. These banks were chartered by the local provincial Government, which subscribed the total or a large share of the capital. Their chief business was therefore in connection with provincial finances. Deposits of public funds were their principal liability, while their most important assets

were loans to the provincial Government and its subsidiary agencies and investments in provincial Government bonds. In the early 'thirties, provincial banks (for instance, the Kwangtung Provincial Bank) participated in the financing of industrial plans of local Governments, which usually entailed rather heavy losses. Legal limitations were written in the charters of the banks; for instance, the lending of the Hupeh Provincial Bank to local authorities was limited to CN$500,000, for a term of 6 months and against security of local bonds. No limitations existed, however, as to the sums which could be invested in provincial bonds.

General banking was also part of their business. They received deposits under various terms, issued bonds, granted loans against goods deposited in the banks' or other go-downs and on real estate and transferred sums, usually within and in some cases outside the province. Few provincial banks, however, handled foreign exchange and foreign remittances; the Kwangtung Provincial Bank inaugurated a foreign remittances service in April 1936. Savings departments and farmers' loans departments, both with separate administration, were maintained by several banks. Beginning in 1934, because of the widespread failures of native banks, special funds were set aside for petty loans to small merchants and farmers. The amount of these loans was generally limited to CN$500, the term to between three and six months and the interest to 1 per cent a month; as security, crops and commodities were accepted.

Before the currency reform of 1935 and to some extent even afterward, the outstanding activity of provincial banks was the issue of yuan bank notes (based upon the national currency or the local silver standard), and subsidiary currency (based upon silver and copper coins). Frequently, however, these notes became irredeemable. With the extension of the political control of the National Government and of the use of the national yuan, provincial note issues lost ground rapidly. After 1935, the policy of the National Government was directed toward limiting the issues of provincial banks to subsidiary notes, within amounts authorized for a limited period of time. In 1934-36 a wide reorganization of local currency was carried on along these lines.

The reorganization of Szechwan currency in 1935 was the

outstanding monetary achievement of the Central Bank of China. The Provincial Bank of Szechwan was established by the Twenty-first Chinese Army during the 1934 campaign against the Communists, with a capital of 1.2 million local yuan paid up with official funds. During a few months of operations, 32 million local yuan notes were issued; this resulted in bank runs and rapid currency depreciation. In 1935, upon instruction from Generalissimo Chiang Kai-shek, the Ministry of Finance made arrangements for the issue of 30 million national yuan in Treasury notes, at a price of 98 and interest of 5 per mille per month, secured on local provincial revenues and redeemable in five years and four months. In July 1935 the Central Bank of China opened a branch in Chungking, took over the provincial silver reserves (amounting to CN$1.2 million) and issued national notes at par with local currency. In September the circulation of local bank notes was forbidden, and by the end of November 1935 it was estimated that 98 per cent of them had been exchanged for national currency.

The Fu-Tien Bank, of Yunnan province, went into bankruptcy in 1929 and reopened again in 1932, with the name of the New Fu-Tien Bank and a capital of 3.3 million local yuan. Some 16 million local yuan in paper notes was already in the market, and new notes were issued, probably up to a total of 30 million local yuan. In 1935 the provincial Government, with a view toward reorganizing the local currency system, granted to the bank the monopoly of tin export; when this was lifted, the exporters were required to deposit with the bank the receipts of sales made out of the province. Movements of silver and gold were also subjected to the bank's permission. The currency was thus stabilized at 10 local to 1 national yuan, and maintenance of this stability was facilitated in 1936 by the inflow of funds from the military expenditures made in the province by the National Army during its short campaign in southern China. It is believed that about 1 million yuan in national currency was imported into Yunnan on that occasion; by the end of 1936 the amount of provincial notes in circulation was estimated to be less than 20 million local yuan, or about 2 million national yuan. At the beginning of 1937 an official exchange rate of 1 national yuan for 10 old Fu-Tien

Bank one-yuan notes and 5 New Fu-Tien Bank one-yuan notes was established by the National Government.

The currency of the Kwangtung Provincial Bank consisted of notes based upon "small money" (subsidiary silver coins), with a value about 20 per cent below the parity of "big money" (national silver yuan). In 1936, after the Kwangtung Provincial Bank had been brought under the control of the National Government by an internal reorganization of the staff, it was entrusted with the task of stabilizing the local currency and introducing the national currency. The issue of the Kwangtung Provincial Bank and its rate of exchange between November 1935 and August 1936 are shown in table 12.

TABLE 12

NOTE ISSUE AND RATES OF EXCHANGE IN KWANGTUNG

November 1935–August 1936

	Note issue (in thousands of Kwangtung yuan)	Monthly fluctuations in the rates of exchange of Canton on			
		Shanghai		*Hongkong*	
		High	*Low*	*High*	*Low*
Beginning of:					
1935					
November......	35,918	147.70	111.00	163.75	147.25
December......	72,911	121.62	107.00	154.50	131.95
1936					
January........	81,411	130.13	120.24	142.65	128.50
February.......	101,992	135.84	172.34	148.65	139.35
March.........	133,886	139.99	136.54	153.15	148.60
April..........	156,649	141.11	138.63	154.12	152.32
May..........	178,867	158.82	140.33	161.65	153.30
June...........	210,301	173.22	153.02	187.05	163.82
July...........	227,582	182.02	151.17	196.00	157.97
August.........	241,052	150.60	147.00	159.80	151.20

Source: Kwangtung Provincial Bank.

The rapid increase in the note issue and the depreciation of the exchange rate during 1936 were due to the military operations of the local authorities against the National Government. By the middle of August 1936 the Kwangtung Provincial Bank had 241 million local yuan notes in circulation which were covered by 125 million local yuan in small silver coins and 116 million local yuan in bonds and notes, issued by the provincial Government and worth hardly anything. The rate of exchange of the local currency to the national yuan was fixed by the bank at 1.44 to 1, and the silver was turned over to the local branch of the Currency Reserve Board. For the purpose

of additional reserve against note issue, the National Government advanced 120 million yuan in Government bonds to the bank at 4 per cent interest and on the security of local tax receipts. The provincial bank was expected to withdraw all the local notes in circulation and to give up its right of issue by the end of 1937.

In Kwangsi, a system of control of foreign and inter-provincial exchanges was established by the Provincial Bank of Kwangsi in the middle of 1936 and a program of currency reform was initiated in the autumn of 1936 along lines similar to those adopted in Kwangtung. The rate of exchange was originally fixed at 1.60 local to 1 national yuan, but later on it was changed to 2 local to 1 national yuan. The note issue was estimated at 6.6 million local yuan in 1934, at 20 million in 1935 and at 40 million to 60 million in October 1936.

When hostilities between China and Japan began in July 1937, the National Government had the situation in central China well in hand, both politically and financially, and the provincial banks in that zone were following a rather conservative policy. A complicated situation existed in northern China, which, after the occupation of Manchuria in 1932, had become a "no man's land" where a conflict among diverse political forces was developing.

The Provincial Bank of Hopei (established in 1930 with a capital of CN$4 million) had followed a conservative policy up to the middle of 1935, its notes in circulation being limited to CN$3 million to CN$5 million. In October 1935, however, a panicky situation developed in Tientsin and Peiping, and the Chinese banks were forced to place restrictions upon the cash withdrawal of deposits. During 1936 local influences were so effective, that the Central Bank of China was prevented from acting in the exchange of silver against national currency, and the removal of silver from the modern banks in Tientsin and Peiping to Shanghai was forestalled. A branch of the Currency Reserve Board was established in Tientsin and the Provincial Bank of Hopei was allowed to play the decisive role in the area, in lieu of the Central Bank of China. When the delivery of silver was effected by the foreign banks, two thirds of it, or nearly CN$6 million, was deposited with the provincial bank, instead of with the legally appointed Government banks.

In May 1936 the Hopei-Chahar Political Council issued an order designating the Provincial Bank of Hopei (a) as the fiscal agent of the provincial Government of Hopei and (b) as the organ for the unification of the note issue in the Hopei-Chahar area. Moreover, the order required the various military and civil authorities only to use the notes of the Provincial Bank of Hopei for all receipts and expenditures. Following an inquiry by the Ministry of Finance, the Council gave its formal support to the monetary policy of the National Government and declared that the notes of the Government banks were to circulate freely in the area. Thus, the legal situation had been reversed, and the rights and powers of the central bank in northern China were placed in the hands of the Provincial Bank of Hopei. Its circulation at the end of 1936 was estimated at more than CN$60 million, with reserves believed to be not only small, but inadequate. Moreover, as the provincial bank was not dealing in foreign exchanges, the cashing of its notes against check or telegraphic transfer on foreign commercial centers could not be effected directly, and its notes were really not redeemable. The worst feature, however, was the fact that the bank was a "no country's bank" in a "no man's land." Nanking authorities disclaimed responsibility for the note issue, and influential foreign groups (i.e., Japanese) referred to it as a "Chinese affair." Only the full conquest of northern China by the Japanese helped to clarify this complicated situation.

In East Hopei, on the Manchukuo border, a politically autonomous administration was set up and a Central Bank of East Hopei was organized in the summer of 1936, after the pattern of the Central Bank of Manchou. Japanese interests backing the Bank of Manchou were behind the new institution. Details are lacking, but it appears that the bank's scope of operations at the middle of 1937 was very limited.

Municipal Banks. There were seven municipal banks in China in 1936; namely, the City Bank of Greater Shanghai, the Peiping City Bank, the Citizens Bank of Tientsin, the Agricultural and Industrial Bank of the City of Tsingtao, the City Bank of Nanking, the Nanchang City Bank and the Canton Municipal Bank; all established after 1927. The capital of these banks ranged from 300,000 local yuan at Tsingtao to 3 million local yuan at Canton. A capital of 1 million local

yuan was the standard amount, contributed by the municipal Government in every case.

The chief business of these banks consisted of handling municipal receipts and expenditures, and their principal resources consisted of public funds. During the 'thirties some municipal banks (Hankow, Canton, Tientsin, Nanking) established special credit bureaus, which advanced loans to small merchants and peddlers, at interest rates ranging from 8 to 10 per mille per month, for limited sums to be repaid by installments. No security, or only nominal security, was required. These loans became especially necessary in those localities where the bankruptcies of the native banks had closed the credit source of small merchants. Some municipal banks (Canton, Nanchang) issued limited amounts of bank notes, mainly in subsidiary currency, which were maintained at par with the notes of the local provincial bank.

Between 1932 and 1935 the combined balance sheet of provincial and municipal banks expanded by 121.8 per cent, as shown in table 13.

TABLE 13

ASSETS AND LIABILITIES OF PROVINCIAL AND MUNICIPAL BANKS 1932–1935

(In thousands of national yuan)

	1932	*1933*	*1934*	*1935*
Assets				
Cash on hand	18,778	17,032	20,179	91,657
Loans, discounts, overdrafts	117,248	147,812	158,730	186,174
Investments	6,230	6,761	11,289	16,214
Bank premises	5,651	8,741	7,529	16,041
Other assets	121	110	740	355
Reserve against notes in circulation	49,220	65,577	68,238	128,015
Reserve against notes issued for account of other banks	4,370	5,100	12,760	9,051
Liabilities				
Paid-up capital	37,078	42,056	32,085	37,161
Reserve funds	3,624	4,138	4,736	5,711
Deposits	103,139	118,172	150,979	250,554
Drafts issued	1,937	7,607	4,373	5,477
Other liabilities	54	46	26	31
Net profits	1,460	2,350	3,646	5,443
Notes in circulation	49,677	71,384	70,860	134,200
Notes issued for account of other banks	4,650	5,380	12,760	8,930
Total Assets/Liabilities	201,619	251,133	279,465	447,507

Note: See note to Table 9.
Source: *The Chinese Bankers Yearbook*, 1936.

THE ORDINARY BANKING GROUP

The ordinary banking group included semi-private or private institutions handling commercial savings and special financial business. Although banking specialization had not developed, a grouping of the institutions may be made on the basis of the statistical tabulation adopted by the Research Department of the Bank of China:[17]

(a) Commercial banks, with commercial and general banking functions;

(b) Savings banks, developing the special field of savings and investment business;

(c) Special banks, or banking institutions with special purposes;

(d) Overseas Chinese banks, with position and functions intermediate between foreign and Chinese Banks;

(e) Other nonbanking institutions, such as the Postal Remittances and Savings Bank, savings societies, trust companies, investment companies, etc.

Auxiliary organizations, set up by the banking institutions, were designed to maintain interbank co-operation.

Banking Legislation. Before 1929, the banks were regulated by the Banking Laws and Regulations issued during the Manchou regime; new Regulations for the Registration of Banks and By-Laws for the Enforcement of Bank Registration Regulations were promulgated in that year by the National Government. The Regulations for the Registration of Banks were applied similarly to native and modern and private and official banks. These regulations provided that "persons establishing a bank and engaged in the business of receiving deposits, advancing loans, making monetary remittances, or discounting bills" should register with the Minister of Finance before establishing or amalgamating banking institutions, deposit the capital of the prospective institution with the Central Bank of China upon application for registration and pay registration fees charged according to the amount of the capital. The scope of the business, the name of the promoter and a detailed history

[17] This tabulation is based on nominal rather than actual functions performed by the banks. For example, the so-called industrial banks, which are in reality part of the commercial banking system and include some of the largest commercial institutions, are grouped by the Bank of China with the agricultural banks.

of the proprietors of unlimited liability firms, among other information, were also required. With the exception of savings banks, which were placed under special regulations in 1935, commercial banks were subjected only to the requirements of registration.

A banking law was promulgated in 1931, but no date was fixed for its actual enforcement. A bank was defined as a business concern undertaking any or all of the following operations: (a) receiving deposits and granting loans; (b) discounting notes and bills or drafts; (c) issuing bills of exchange and documentary bills or drafts (Art. 1). All banks are required to be organized under the Corporation Law (a) as joint stock limited corporations, as partnership corporations or as joint stock partnership corporations, or (b) as unlimited corporations (Art. 2, 5). The capital requirement in the first case was fixed at CN$500,000, in the second case at CN$200,000; a reduction to CN$250,000 and to CN$50,000, respectively, could be granted by the Ministry of Finance for banks in centers of minor importance. The shareholders of banks organized under limited liability clauses were made liable for an amount double the par value of the share which they subscribed or held (Art. 5). The banks established under the unlimited liability clause (native banks) were required to deposit with the Central Bank of China a guarantee fund amounting to 20 per cent of their capital (Arts. 14-16). Full cash payment of the shares of limited corporations was required within a period of three years (Arts. 5, 7, 38).

Banks were allowed to transact any business which did not involve loans on or purchase of their own shares, the direct participation in other business concerns or banks and advances to any private individual or organization of sums exceeding 10 per cent of the total amount of reserves and paid-up capital (Arts. 10, 11, 34). Trust activities could be undertaken only with the permission of the Ministry of Finance and with separate capital and departmental administration (Arts. 29, 32). Other transactions were limited to purchase and sale of bullion and securities, underwriting of public bonds and corporation securities, warehousing, custody of valuables, collection and payment of money on behalf of customers and any other financial operation which was undertaken under the supervision and direction of the Ministry of Finance and jointly with other banks of the district (Arts. 9, 33).

Operations of the banks were placed under the strict supervision of the Ministry of Finance, to which they were required to report at the end of each accounting period, in June and December (Arts. 17-19). Permission of the Ministry of Finance was necessary for any change affecting third parties, such as a change in the capital or the establishment or closing of branches (Arts. 26-28). Moreover, the Ministry of Finance had authority to order any bank to submit reports, documents and accounts for inspection, and to change the business policy or the officers within a definite period of time, upon finding the financial conditions or the reports of the bank unsatisfactory. Further, to protect the public interest, the Ministry of Finance was also empowered to suspend the operations and seize the assets of the banks (Arts. 22-25, 45, 46).

In case of liquidation, a bank's assets were placed under the direct control of the Ministry of Finance, and repayments of liabilities were scheduled in such a way as to give preference to notes, savings accounts and deposits, in that order (Arts. 41-44). These rules for the liquidation of banks were supplemented by other regulations of the Ministry of Finance issued on June 5, 1935, which provided that operations relating to the liquidation of a bank should be performed within a period of three months by a supervisor appointed by the Ministry of Finance.

It is worthwhile to note the Banking Law of 1931 did not follow the lines of the Project for a Banking Law prepared in 1928-1929 by the Kemmerer Commission of Financial Experts for China. For instance, the law did not contain provisions for legal reserves to be maintained at the central bank against deposits. On the other hand, it introduced both double liability for shareholders of modern banks and the special guarantee fund of 20 per cent of capital for native banks, neither of which was included in the Kemmerer project. In fact, the Kemmerer project was rather severely criticized by Chinese bankers, on the ground that its provisions could not be applied to Chinese institutions, unless foreign banks were also subjected to the same restrictions. It was also maintained that the Kemmerer proposals were out of harmony with the Chinese economic structure.

In some points the law of 1931 can be better understood on the basis of Chinese banking traditions (e.g., the provision

permitting banks to maintain warehouses) and, in general, on the basis of the political-social program of the Kuomintang, which called for a controlled economy and an essentially public banking structure. The exceptional discretionary power of the Ministry of Finance was a means to bring operations of private banks into harmony with the policy of the National Government. The law followed closely the pattern of the Japanese banking regulations; many provisions, such as those relating to the authority of the Ministry of Finance, were in fact the same in Chinese and Japanese law.

The internal organization of an ordinary bank was on a department basis. Its savings department was regulated by the Savings Bank Law of 1935, which required that any bank establishing a savings department should (a) have a paid-up capital of at least CN$1 million and (b) maintain separate accounting for operations of the department. All large institutions set up savings departments, and others also maintained trust departments at least in their largest branches. The capital allocated to a savings department was usually CN$100,000, ranging from CN$50,000 to CN$600,000; trust departments were given smaller capital. Other departments (foreign exchange, trading, services, realty, insurance, etc.) were also set up, usually without separate administration. Relations among the various departments were never very well defined.

Commercial Banks. There were seventy-four commercial banks at the end of 1935. The head offices of the largest banks were mainly located in Shanghai, where they had originally been established, or transferred after 1927; the only exceptions were the Continental Bank in Tientsin, the Commercial Guarantee Bank of Chihli in Peiping, the Young Brothers Banking Corporation and the Mei Feng Bank of Szechwan in Chungking. All banks (except for the Commercial Guarantee Bank of Chihli, the Mei Feng Bank of Szechwan, the Tah Chung Bank and the Chung Wai Bank) were members of the Shanghai Bankers Association, either through their head offices or their branches in the city.

Changes in their combined balance sheet between 1932 and 1935 are shown in table 14.

The expansion of all commercial banks between 1932 and 1935 (37.4 per cent) was considerably lower than the rate of

TABLE 14

ASSETS AND LIABILITIES OF COMMERCIAL BANKING INSTITUTIONS

1932–1935

(In thousands of national yuan)

	1932	1933	1934	1935
Assets				
Cash on hand	72,674	73,951	81,658	61,573
Loans, discounts, overdrafts	624,419	729,563	856,485	809,345
Investments	78,811	111,018	149,499	149,043
Bank premises	42,611	50,465	56,333	60,551
Other assets	10,068	14,150	20,468	13,497
Reserve against notes in circulation	35,067	54,589	75,158	27,694
Reserve against notes issued for account of other banks	32,470	40,451	80,169	109,681
Liabilities				
Paid-up capital	57,781	65,644	72,090	74,619
Reserve funds	18,423	23,773	30,569	31,023
Deposits	716,936	848,357	1,006,454	942,353
Drafts issued	8,365	7,467	18,994	21,323
Other liabilities	9,702	15,033	22,852	13,164
Net profits	7,261	7,690	9,147	8,750
Notes in circulation	35,699	55,683	75,695	27,694
Notes issued for account of other banks	41,955	50,630	83,967	112,457
Total Assets/Liabilities	896,122	1,074,277	1,319,770	1,231,383

Note: See Note to Table 9.
Source: *The Chinese Bankers Yearbook*, 1936.

increase in the Government and other official banks. The increase in the balance sheet of the "big five" commercial banks is indicated in table 15.

TABLE 15

TOTAL ASSETS/LIABILITIES OF THE "BIG FIVE" COMMERCIAL BANKS

1928, 1932 and 1934–1935

(In thousands of national yuan)

	1928	1932	1924	1935
Shanghai Commercial and Savings Bank	58,482	166,837	231,213	212,236
Kincheng Banking Corporation	71,929	116,342	155,693	172,291
China and South Sea Bank	49,568	106,326	143,234	148,732
Continental Bank	41,752	86,412	144,850	137,444
National Commercial Bank	58,228	95,402	120,706	108,589
Grand Total	279,959	571,319	795,696	779,292
Percentage of total assets/liabilities of all commercial banks	..	64.27	60.15	63.28

Source: Annual Reports of the banks.

In addition to these "big five" there was a group of middle-sized banks, with resources of CN$10 million to CN$100 million. At the end of 1935 this group included the following nine institutions: Ningpo Commercial and Savings Bank (CN$94,244,437), Commercial Bank of China (CN$64,727,693), China State Bank (CN$50,646,494), Young Brothers Banking Corporation (CN$37,018,956), Chung Foo Union Bank (CN$27,773,977), Chung Wai Bank (CN$15,261,105), Mei Feng Bank of Szechwan (CN$14,896,379), Commercial Guarantee Bank of Chihli (CN$13,668,783) and Tah Chung Bank (CN$12,075,510). With their combined resources, these fourteen banks controlled four fifths of the total assets of all commercial banks.

This clearly indicates that the concentration of banking resources was well advanced. The remaining sixty banks had total assets of CN$1 million to CN$10 million each, and developed activities of only a limited and local nature. Although resources were highly concentrated, the number of small institutions was evidently far above actual requirements. There was no official policy directed to strengthen the small banks by combining their resources, as, for instance, in the Japanese banking policy, although amalgamations on private initiative were regarded with favor.

The serious plight through which many banks passed during 1935 brought about a policy of intervention by the National Government. In April 1935 two of the largest institutions, the Ningpo Commercial and Savings Bank and the Commercial Bank of China, received advances from the Government totaling CN$5 million each, being simultaneously placed under public control. In March 1937 the Government proceeded to reorganize the two banks by raising new capital of CN$4 million through purchase of bank stock. The losses suffered by the banks required the writing off of about 85 per cent of the original capital (which was CN$7 million for the Commercial Bank of China and CN$2.25 million for the Ningpo Commercial and Savings Bank); therefore, the two banks were actually converted into Government-owned institutions.

The *liabilities* of the commercial banks consisted mainly of deposits. Before 1934, deposits increased more rapidly than capital and reserves. They contracted sharply during 1935, but resumed the upward trend again in 1936. Deposits were

about twelve times larger than capital, the latter representing about 7 per cent of the total assets. The average paid-up capital of commercial banks was CN$200,000; in the case of the "big five," capital ranged from CN$5 million to CN$7.5 million. At the end of 1935 the capital and reserves of the Shanghai Commercial and Savings Bank amounted to CN$11.8 million and deposits totaled CN$131.6 million; capital funds represented 8.9 per cent of deposits and 5.6 per cent of total liabilities. In the case of the Kincheng Banking Corporation, the ratio between capital and deposits was lower (6.5 per cent), although the ratio between capital and total liabilities was higher (5.9 per cent), this being due to the absence of note issue. In the case of the National Commercial and Savings Bank, the ratios at the end of 1935 were 7.6 per cent and 5.9 per cent, respectively.

During the years preceding the opening of Sino-Japanese hostilities, the expansion of deposits was particularly rapid among the largest banks and mainly took the form of fixed accounts. This may be explained, first, by the accumulation of idle funds in Shanghai and the policy of the banks of attracting fixed deposits through higher interest rates and, second, by the establishment of the savings and trust banking departments. Between 1928 and 1935, the ratio of fixed accounts (including fixed savings and trust accounts) to current accounts in the Shanghai Commercial and Savings Bank rose from 47.8 to 127.6 per cent, and in the National Commercial Bank it rose from 115.7 to 134.3 per cent, but it declined slightly (from 91.6 to 90.0 per cent) in the Kincheng Banking Corporation, which maintained its branches principally in northern China.

Deposits were accepted by the largest banks in national, local and foreign currencies. Current accounts could be withdrawn by checks or by passbooks entries (similar to the Japanese special current accounts); fixed accounts were for periods from three months to two or more years and were withdrawable only upon advance notice. Interest rates for fixed deposits ranged from 4 to 8 per cent. Deposits in the savings department were accepted for periods from three months to ten years, for amounts from CN$10 to CN$20,000 and at interest from 5 to 10 per cent.

The *assets* of commercial banks consisted mainly of loans,

overdrafts and discounts, the total of which accounted for 69.5 per cent of total assets in 1932 and for 64.8 per cent in 1935. This decline was due in general to an expansion in the reserve held against notes issued for account of other banks and to an increase in investments. The nature of bank credit is shown in the analysis in table 16 of the loans made by the Kincheng Banking Corporation.

TABLE 16

LOANS OF THE KINCHENG BANKING CORPORATION

1934 and 1935

(Percentage distribution)

	1934	*1935*
Commerce	35.2	41.3
Industries	21.7	14.5
Communications and other public utilities	14.0	13.3
Agriculture and agricultural products	3.4	9.2
Mining and mineral products	5.3	7.8
Real estate	..	7.8
Government agencies	5.3	..
Public and private associations and institutions	15.1	6.1
Total	100.0	100.0

Source: Annual Reports of the Kincheng Banking Corporation.

In addition, of the loans made by the savings department of this bank, 62.9 per cent in 1934 and 41.1 per cent in 1935 were covered by mortgages, the balance consisting of loans on securities. The credit of the savings department usually represented about 30 per cent of the outstanding credit of all other departments.

Commercial loans were granted mainly on the security of commodities deposited in the go-down (warehouse) of the lending bank, or of the receipt of commodities deposited in other go-downs. The extensive system of go-downs kept by modern banks is explained by the lack of commercial paper and the tradition of lending on commodities. Of the merchandise, grain, flour, cotton and coal were most acceptable in northern and northwestern China; cotton yarn, rice, silk and tea in central and southern China; sesamum oil, rice, grain and tin in southwestern China.

Similar methods were used in financing the intermediary stages of production. Chinese industries were generally undercapitalized, and in some cases they even lacked sufficient liquid funds to buy one week's supply of raw materials. Working

capital was supplied by the banks against a deposit of raw materials or finished goods in go-downs. The turnover of these loans was very high, because whenever the factories needed raw materials for manufacturing purposes, the industrialists used the cash obtained from sales of manufactured products to repay part of the debt and obtain the release of raw materials with which to work. Longer term financing of industry was provided on the security of the *tsangchi*, which was a kind of mortgage on factory site, building and machinery. Such loans had the character of direct investments and expanded or contracted according to fluctuations in land values, on which they were chiefly secured; they often amounted to 50 per cent and more of the paid-up capital of the industry.

The combined value of these two forms of industrial bank credit, on commodities and on *tsangschi*, was often equivalent to, and sometimes exceeded, the capital of the industries. In the case of the cotton mills, the annual cost of credit financing amounted to as much as 20 per cent of the capital. Industrial loans of the Shanghai Commercial and Savings Bank amounted to 34 per cent of its total loans in 1931, to 41 per cent in 1932, to 33 per cent in 1933, to 24 per cent in 1934. In 1934 its loans to cotton mills amounted to 66 per cent and those to flour mills amounted to 14 per cent of all industrial loans. About 60 per cent of the industrial loans of this bank were secured by commodities and about 30 per cent were covered by mortgage on factory site. In 1935, the Shanghai Commercial and Savings Bank, the Kincheng Banking Corporation, the Bank of China and other banks, assumed control of a number of textile factories in order to safeguard their investments in this important Chinese industry.

Despite this evident interest in industry, commercial banks never became investment institutions, launching and supporting new enterprises. Loans were granted to enterprises already in operation; the theory apparently was that it was the business of an industrial firm to get started and the business of a bank to provide it with working capital on the basis of some solid security, such as that offered by a mortgage on commodities in go-downs.

Next in volume to commercial and industrial bank credit was the credit involved in the financing of public utilities, including communication and municipal power plants, water-

works, telephones, etc. The methods of financing municipal utilities were not different from those used for financing industrial enterprises. Loans were granted on the security of the plant, up to the value of the capital of the company but seldom above it. Financing of communications was made mainly for railway building through banking syndicates under the leadership of the Bank of China. These syndicates either made direct advances to the Ministry of Railways or acted as guarantors of purchasing contracts of railway materials on which foreign exporters had granted a credit. The largest commercial banks, such as the Shanghai Commercial and Savings Bank and the Kincheng Banking Corporation, were active participants in these syndicates, together with the Bank of China, the Bank of Communications and the Farmers Bank of China. As security the Ministry of Railways delivered Government bonds, representing the railway loan issue, and granted privileges upon the railway revenue.

Agricultural loans were granted by the banks either on crops or on commodities deposited in go-downs. A special feature of agricultural credit was the active participation which some large banks took in the middle 'thirties in the financing and organizing of farmers' co-operative societies.

Another characteristic feature of the largest banks was the policy of small unsecured loans. Both the Shanghai Commercial and Savings Bank and the Kincheng Banking Corporation set aside special funds for limited unsecured personal advances to small merchants and peddlers. The Shanghai Commercial and Savings Bank started this policy in 1930, granting loans up to CN$500, with a maximum term of one year; in 1934 the Kincheng Banking Corporation, in connection with the municipal Government of Peiping, initiated a system of loans of less than CN$200, for terms from three to six months. This policy was followed by other institutions, installment repayments were introduced and small loans became a general practice. These small personal loans of commercial banks belonged to the same category as those granted by provincial and municipal governments. They were the consequence of the widespread disappearance of native banks, which had been the traditional financing agencies of the small trade and industry of the country.

Private personal loans were granted mainly on the security

of real estate and of bonds and shares. Before 1933, real estate in foreign concessions was considered an excellent risk; bonds and shares afterward became the best security for individual loans, which were granted for amounts up to 70 per cent of the market value of the security. Direct investments in real estate were also common before 1933, but later on banks limited themselves to carrying the properties theretofore acquired, with no new adventures in the field.[18] The security portfolio of the banks consisted largely of Government and other public bonds, and of small amounts of other debentures and shares quoted in the Shanghai and Hongkong markets. The rise in bank investments was due mainly to the absorption of internal Government issues, which were sold by or through the Central Bank of China. Operations in Government bonds, essentially speculative in character, were transacted on the China Merchants Stock Exchange, commonly known as the Government Bond Exchange. Theoretically, transactions in Chinese stocks were also admitted, but the amount of this business was insignificant. The exchange ceased operations on August 14, 1937.

Among *other operations,* internal remittances and various services for customers should be mentioned. Internal remittances provided a sizable portion of the banks' earnings, so long as the inter-provincial rates varied from center to center. After 1935, the equalization of all rates with the charge of a uniform commission of 1 per cent greatly decreased the importance of remittances in bank earnings. The services for customers included safekeeping, warehousing, credit information, etc.

Note issue was also an important operation of commercial banks before 1935. At the end of 1934, the right to issue notes was still granted to six commercial banks, namely, the National Commercial Bank, the Commercial Bank of China, the China and South Sea Bank, the Ningpo Commercial and Savings Bank, the Commercial Bank of Chihli and the Tah Chung Bank. During the course of 1935 the first two banks exchanged their notes for national yuan notes issued by the Government banks, and with the monetary reform of November 3, 1935, all commercial banks lost the privilege of note

[18] Direct investments in real estate were made chiefly, but not exclusively, with funds of the savings department of the banks.

issue. However, they maintained the system of indirect note issue which was started in 1915 by the Chekiang Industrial Bank and subsequently adopted by a large number of banks; the notes were obtained from the legal banks of issue by paying 60 per cent in cash (i.e. silver, gold and foreign exchange) and 40 per cent in securities, in such form and types as to fulfill the legal requirements of the reserve against the circulation. Silver stocks never were of special importance among commercial banks and after the decree of November 3, 1935, they were delivered to the Currency Reserve Board and its branches on the same basis as those belonging to the foreign banks.

Savings Banks. Savings banks were regulated by the Savings Bank Law, which was promulgated and became effective on July 4, 1935.

This law defined savings banks as "all business concerns receiving small deposits and paying compound interest" (Art. 1). It provided that savings banks should be organized on the basis of limited liability, with capital of not less than CN$500,-000, which, however, could be reduced to a minimum of CN$100,000 upon approval of the Ministry of Finance in the case of banks situated in commercially undeveloped centers. (Arts. 2, 3). The establishment of savings banks required approval of the Ministry of Finance (Art. 2), which was charged with supervising their operations (Art. 11). The savings banks were authorized to transact savings and other ordinary banking business (Art. 4), but current deposits were limited to CN$5,000 per account and to 40 per cent of the total savings accounts. Moreover, current deposits were not withdrawable by check (Art. 5) and limitations were placed upon the employment of the capital fund, in order to favor investment in Government bonds and agricultural loans (Art. 7). Loans by savings banks to other banks or against commercial paper were limited to 15 per cent of the total amount of deposits (Art. 8). Savings banks were required to maintain government bonds or other reliable securities with the Central Bank of China equivalent in value to not less than one fourth of their total savings funds (Art. 9). Directors and supervisors had joint unlimited liability for the repayment of the claims of the depositors (Art. 15).

Savings banks failed to develop. No more than six were

established and their combined assets were less than CN$50 million, as indicated by table 17.

TABLE 17

ASSETS AND LIABILITIES OF SAVINGS BANKS

1932–1935

(In thousands of national yuan)

	1932	*1933*	*1934*	*1935*
Assets				
Cash on hand	2,280	1,978	1,235	817
Loans, discounts, overdrafts	15,099	25,924	32,846	27,680
Investments	3,254	5,360	7,637	6,031
Bank premises	1,757	2,516	3,089	2,665
Net losses	..	..	349	..
Reserve against notes issued for account of other banks	1,370	1,950	3,003	2,550
Liabilities				
Paid-up capital	3,440	3,492	3,500	2,501
Reserve funds	130	200	188	181
Deposits	18,512	31,735	41,389	32,718
Drafts issued	23	34	80	3
Net profits	285	307	160	190
Notes issued for account of other banks	1,370	1,950	3,003	4,150
Total Assets/Liabilities	23,760	37,728	48,160	39,743

Note: See note to Table 9.
Source: *The Chinese Bankers Yearbook*, 1936.

The only important savings bank was the Sin Hua Trust and Savings Bank, having a capital of CN$2 million and accounts of CN$37.7 million at the end of 1935. It was reorganized in 1931, under the auspices of the Bank of China and the Bank of Communications. Its internal organization consisted of two departments, savings and trust, each provided with half the total capital. The bank transacted all kinds of commercial business, including remittances and exchange. At the end of 1935, real estate amounted to CN$2.5 million, securities amounted to CN$5.8 million and fixed loans were CN$8.8 million—in other words, direct and indirect investments represented 45.4 per cent of the assets of the bank. The bank also advanced small loans to individuals, peddlers and small traders; these loans were unsecured, with a maximum term of one year, repayable by installments and normally settled at the beginning of the Lunar new year.

Special Banks. Special banks included those institutions which had originally been formed for a particular purpose.

Banking specialization, however, never advanced in China, and all banks generally transacted any type of business. Only the local farmers' banks showed a significant degree of specialization, which arose from the limited range of their business rather than from a qualitative discrimination in operations.

Agricultural banks were the most numerous; they were established on the initiative of national, provincial and *hsien* (district) authorities.

The Farmers Bank of China, which in 1935 was officially recognized as one of the Government central banks, was purposely created as an official institution for productive short- intermediate- and long-term credit to agriculture, with funds obtained from note issue, deposits and issues of debentures. Aside from organizing and financing co-operative societies, however, the bank failed to develop extensively in this field until the middle of 1936, when it was instructed by the Ministry of Finance to set aside a fund of CN$50 million for loans on mortgage of farmland and for the expansion of rural credit business in general.

At the end of 1935, the Provincial Farmers Bank of Kiangsu (the only provincial agricultural bank in existence) had a capital of almost CN$4 million and total assets amounting to more than CN$22 million. This bank was particularly active in developing co-operative societies in the province and was granted the right of subsidiary note issue with legal tender privilege within the province.

The other farmers' banks were established in 1934-1935 by *hsien* authorities. Their resources usually amounted to CN$150,000 to CN$250,000, but in some cases these were even less than CN$50,000. Capital was usually raised by taxation or by contributions from local well-to-do landlords. Of the fifteen banks existing at the end of 1935, ten or more were situated in Chekiang and Szechwan. Their activities were purely local, differing little from those of the farmers' loans bureaus established in other districts for the purpose of providing credit to individual farmers and co-operative societies.

Among the so-called industrial banks were some of the leading modern banks; they did little or no industrial financing and could hardly be distinguished from commercial banks. They were organized as semi-public or private institutions. The largest bank in this group was the National Industrial

Bank of China, with a capital of CN$3.5 million, of which the National Government held CN$60,000 at the end of 1934. The bank was organized into a general section and three special departments (savings, insurance, warehouse), each having autonomous administration. At the end of 1935 its resources totaled CN$106.7 million, of which reserves for notes in circulation accounted for CN$43.4 million. In April 1935 the bank encountered difficulties and the Government made advances totaling CN$5 million. In March 1937 it was reorganized into a public institution; probably 85 per cent of the original capital was written off, and the Government supplied new capital to the extent of CN$4 million.

The Manufacturers Bank of China was promoted by the Ministry of Industry in 1928-1929. It was organized as a semipublic institution, with a capital of CN$5 million, of which the Government held about 20 per cent, the balance being in the hands of merchants. Its administration was jointly controlled by the Government, which appointed six directors, and the merchants, who elected nine directors. The official purpose of the bank was the extension of long term secured loans to the industries, and the issue of bonds, debentures, stocks and shares on behalf of corporations. Its assets at the end of 1935 totaled CN$53.8 million.

The third important institution was the Chekiang Industrial Bank, which was originally established as a provincial semi-public enterprise and later on transferred to private ownership. In the 'twenties the bank was prominent as a foreign exchange institution, rather than as an investment bank, but in the 'thirties it promoted the flotation of debentures for account of public utilities, industrial enterprises and real estate companies. At the end of 1935 its assets amounted to CN$67.6 million. None of the other four so-called industrial banks was of any particular importance.

The avowed purpose of other special banks was to serve a particular field of activity. Some of them were among the most important banking institutions of the country. The Yien Yieh Commercial Bank of Tientsin was one of the largest banks, having total resources amounting to CN$124.9 million at the end of 1935. At the same time, the liabilities of the Land Bank of China, reorganized in Shanghai in 1929, totaled CN$37.9 million, of which CN$7.5 million consisted of notes

in circulation. The Silk Bank in Canton was one of the most active local special banks. Other special banks included a pawnbrokers' bank in Hangchow (Chekiang), and salt, coal and silk institutions in Shanghai and Chungking.

Development banks, with the avowed purpose of fostering agriculture and industry in general, or with colonization in the border provinces as a special field, were often among the largest banking institutions in China. The Agricultural and Industrial Bank of China, a Government-promoted and privately owned bank, had a balance sheet total amounting to CN$66.9 million at the end of 1935, of which CN$16.5 million was represented by note issue. Some of these banks were interprovincial institutions, such as the Frontier Bank of Tientsin. At the end of 1935, its resources amounted to CN$4.4 million, of which CN$270,000 represented note issue and CN$2 million was capital. The National Government held a share of CN$50,000 in the capital. The other banks were institutions owned by provincial Governments, such as the Reconstruction Bank of Kiangsi, and private institutions such as some banks in Szechwan.

At the end of 1935 there were forty-six special banks, of which sixteen were classified as agricultural (exclusive of the Farmers Bank of China, listed as a central banking institution), seven as industrial, eight as serving special activities, ten as development and five as colonial banks. Prior to November 1935 four special institutions (the Bank of Agriculture and Commerce, the Agricultural and Industrial Bank of China, the National Industrial Bank of China and the Land Bank of China) exercised the right of note issue. The combined balance sheet of all special banks from 1932 to 1935 is shown on page 172. The total assets increased by 15.9 per cent between 1932 and 1935; however, two big banks (Yien Yieh Commercial Bank and National Industrial Bank of China) with assets amounting to CN$90.9 million in 1928 and to CN$231.6 million in 1934, were not included in the combined balance sheet for 1935.

Overseas Chinese Banks. Overseas Chinese banks comprised those institutions established by overseas Chinese. At the end of 1935 nine overseas Chinese banks had branches in China, three of which were from the Straits Settlements, one from the Netherlands East Indies, one from the Philippines and

TABLE 18

ASSETS AND LIABILITIES OF THE SPECIAL BANKS

1932–1935

(In thousands of national yuan)

	1932	*1933*	*1934*	*1935*
Assets				
Cash on hand	17,517	20,787	22,329	25,994
Loans, discounts, overdrafts	241,651	274,027	331,259	290,490
Investments	42,902	60,049	71,986	49,055
Bank premises	10,127	13,317	13,788	12,403
Other assets	1,742	1,470	2,600	6,509
Reserves against notes in circulation	47,274	58,303	67,015	29,249
Reserves against notes issued for account of other banks	16,727	19,283	24,120	27,000
Liabilities				
Paid-up capital	37,575	38,117	41,923	39,959
Reserve funds	11,278	12,316	13,461	12,999
Deposits	257,647	309,870	369,942	321,353
Drafts issued	..	1,133	4,518	2,067
Other liabilities	902	2,698	6,451	2,992
Net profits	3,470	4,050	4,655	4,133
Notes in circulation	47,274	58,303	67,015	29,249
Notes issued for account of other banks	17,227	20,749	25,132	27,949
Total Assets/Liabilities	377,940	447,236	533,097	440,700

Note: See note to Table 9.
Source: *The Chinese Bankers Yearbook*, 1936.

four from Hongkong. These banks were registered under foreign law and thus enjoyed the same privileges as foreign institutions. Their balance sheets reflected their activities both within and outside China. These banks were somewhat similar to foreign banks, and they were especially prominent in the field of foreign remittances.

In 1935 the leading overseas institutions were the China Banking Corporation, from Manila (total assets of 25.3 million Philippine pesos), the Overseas Chinese Banking Corporation, from Singapore (total assets of CN$43.1 million) and the Bank of East Asia, from Hongkong (total assets of CN$23.7 million).

This group suffered a hard setback in 1935 with the failure of the Bank of Canton, a Hongkong institution having a capital of Hk$8.7 million and total liabilities of Hk$32.2 million. The bank had been promoted by the co-operation of American and Hongkong Chinese and had branches in Shanghai, Canton, Hankow, San Francisco and Bangkok, dealing especially in remittances to China. The work of liquidating and re-

organizing the bank was entrusted to Dr. T. V. Soong. A new capital of Hk$7.5 million was raised and the bank reopened at the end of 1936, continuing as a Hongkong institution. The limited significance of the overseas Chinese banks was indicated by the fact that the bankruptcy of this bank, one of the most important of the group, did not have important repercussions in Shanghai or Canton.

Non-banking Institutions. The Postal Remittances and Savings Bank was established as the banking department of the Chinese Post Office. In 1930 it was detached from the Post Office and reorganized as an autonomous agency under the direct supervision of the Ministry of Communications. The bank was authorized to receive passbook, fixed and savings deposits; the maximum individual interest-bearing account was fixed at CN$3,000. The minimum deposit was CN$1, although savings stamps for less than CN$1 could be purchased. Interest was paid at regular intervals, or capitalized to be paid with the principal at maturity. In the middle of 1936 there were over 10,000 post offices with remittance and savings facilities. On June 30, 1936, the total liabilities of the bank amounted to CN$85.2 million, of which CN53.4 million was represented by savings deposits. On the asset side, loans and overdrafts amounted to CN$15.1 million, investments in securities to CN$4.4 million, investments in land and buildings to CN$6.0 million and fixed deposits with other banks and cash in other banks to CN$38.1 million. The bank set up special loan offices in distressed areas for assisting farmers with loans for amounts below CN$100 against produce.

Two savings societies were operating at the end of 1935, both subsidiaries of banks. One was the Savings Society of the Ningpo Commercial and Savings Bank, with a capital of CN$500,000 and total assets of CN$6.3 million. The other was the Joint Savings Society of the Yien Yieh, Kincheng, Continental and South Sea banks, a combination formed by four of the largest modern banks. This latter institution had a capital of CN$1 million, and prior to November 1935 it enjoyed the right of note issue. Its growth is shown by the following figures for total assets:

(In millions of national yuan)

1928	*1930*	*1932*	*1934*	*1935*
31.4	56.2	81.5	117.7	128.6

The Society received current and fixed deposits in sums of CN$25 at interest of 7 per cent per annum, simple if for two years, compound if for five years. The principal and interest of all deposits were secured by the founding banks. At the end of 1935, the investments of the Society in bonds and securities amounted to CN$35.2 million, and the investments in real estate to CN$9.2 million; fixed loans totaled CN$33.2 million.

Twelve trust companies were in operation at the end of 1935, of which four were established in that year and did not publish statements. The assets of the other eight companies were only CN$23.5 million. One was owned by the Greater Shanghai City and another was a subsidiary of the Central Bank of China. In 1936, the Tung Yih Trust Company of China, the oldest and the largest, with assets amounting to CN$16.8 million, went into bankruptcy due to frozen investments in real estate.

As in the case of the savings business, the largest trust operations were handled by the trust departments of commercial banks; trust companies were confined to real estate transactions, underwriting of insurance and custody of valuables. They also operated as agents for purchases and sales of securities. In 1937 the Central Trust of China (a subsidiary of the Central Bank of China) took over all the public trust funds and established an affiliated Central Savings Society, which assumed charge of the activities of the lottery savings societies prohibited by the Savings Bank Law of 1935.

The Chinese finance companies remained undeveloped and limited in means and purposes. The Sincere Finance Corporation, the largest in the field, was linked with a chain of commercial enterprises. The total capital of three private finance companies at the end of 1935 amounted to CN$790,000. The China Development Finance Corporation was formed by a banking syndicate and represented an organ of inter-bank cooperation for investment purposes.

INTER-BANK RELATIONS AND CO-OPERATION

Local bankers associations were in existence in 1937 in all large cities, including Shanghai, Tientsin, Hangchow, Chungking, Hankow and Nanking. Although banks were admitted independently of their type or function, membership was very

limited. In 1935 the Shanghai Bankers Association had only thirty-three members, despite the fact that there were fifty-eight head offices and 124 branch offices of modern banks in the city. Admission was restricted to banks having a certain minimum capital and operating in the local market for a given time. In addition, a candidate bank had to be recommended by member banks. The various local associations were co-ordinated through a Chinese Bankers Association, with representatives meeting from time to time to discuss matters of general policy. The ties among the various markets, however, were effectively maintained through the branch system rather than through the bankers' associations.

During the years from 1932 to 1937 banking co-operation was developed on the basis of an eight point policy:

(a) Management of the public debt;
(b) Settlement of inter-bank balances;
(c) Mobilization of bank funds;
(d) Negotiability of bank assets;
(e) Creation of an investment market;
(f) Extension of agricultural credit;
(g) Establishment of a credit information service;
(h) Fostering of scientific banking research.

Management of the Public Debt. In 1927 the Shanghai Bankers Association undertook the initiative of setting up a committee to be entrusted with the management of new Treasury bond issues, secured by customs and tobacco revenues. In 1932 the committee was reorganized as the National Loan Sinking Fund Committee, composed of two representatives each from the Shanghai Bankers Association, the Native Banks Clearing Association and the Shanghai Chamber of Commerce, the Chief Inspector of Customs, and five members appointed by the National Government. The scope of the committee was enlarged, as it was placed in charge of the supervision of all operations connected with the issue, servicing, amortization and redemption of Government bonds. Henceforth, new Government bonds were issued on the basis of an agreement between the Ministry of Finance and the Committee; the Committee would allocate the bonds among the banks, while the Ministry of Finance would undertake to transfer to the three Government banks (the Central Bank of China, the Bank of China and the Bank of Communications), for account

of the Committee, sinking funds according to agreed-upon schedules. The Committee provided adequate facilities for bank co-operation in the distribution and servicing of Government bonds during the years preceding the outbreak of the Sino-Japanese war.

Settlement of Inter-bank Balances. The settlement of inter-bank balances among modern banks was placed on a clearing basis in various cities. Shanghai established the first clearing house on January 10, 1933, followed shortly afterward by Hangchow, Tientsin and Nanking.

The Shanghai Clearing House was organized as a branch of the Joint Reserve Board of the Shanghai Bankers Association. Admission was open to all banking institutions, provided their head office had been in business for at least two full years, and subject to the recommendation of two clearing members and the affirmative resolution of the general meeting of the Joint Reserve Board (Art. 3, Regulations Governing the Clearing House of the Joint Reserve Board of the Shanghai Bankers Association, as revised to September 26, 1933). Membership fees were fixed at CN$1,000, CN$500 and CN$300, and a deposit was required in cash or Joint Reserve notes and certificates of CN$30,000, CN$20,000 or CN$10,000, according to the size of the institution (Arts. 5, 6). Administration of clearing transactions was reserved to the members of the Joint Reserve Board (Arts. 7, 13, 14, 15).

The paper eligible for clearance included bills of exchange and remittance receipts, bank or cashier's orders, checks, certificates for redemption of principal and payment of interest from banks appointed for the amortization of Government loans and other paper approved by the executive committee of the Joint Reserve Board (Art. 16). In order to facilitate settlements, each clearing member was required to maintain a current account with the Joint Reserve Board; these funds were deposited by the Board with the Bank of China, the Bank of Communications and, after January 1, 1936, the Central Bank of China.

Clearing operations were transacted on the floor of the Joint Reserve Board twice a day, first at 1:00 p.m. and again at 3:30 p.m. (Art. 17). At each session each member sent two clerks on the floor with all the items due for settlement with other banks and duplicate exchange slips (Art. 19). The debtor

banks were required to return the items found to be "not good" before 6:00 p.m. (Art. 28). Settlement of balances was effected at 4:00 p.m. and 5:00 p.m. by book transfers of the deposits maintained by the banks with the Joint Reserve Board.

The settlement of the balances of the modern banks with the foreign banks was effected through the Bank of China, and the settlement of the modern banks with the native banks was effected through the Joint Reserve Board of the Shanghai Bankers Association and the Joint Reserve Board of the Native Banks Clearing Association. Non-member banks were allowed to clear through a current account maintained with a clearing member bank.

Mobilization of Bank Funds. The establishment of the Joint Reserve Board of the Shanghai Bankers Association on February 27, 1932, proved to be a most important event in Chinese banking. The purpose of the Board was to make the "slow assets" (i.e., non-readily cashable assets) in the portfolios of the banks liquidatable, in a market lacking any sizeable amount of short-term commercial paper and rediscount facilities. The idea of a Joint Reserve Board originated during the serious period of the Sino-Japanese hostilities at Shanghai, when the fall in land values threatened to become a major catastrophe for the financial market. All Shanghai banks, whether members of the Shanghai Bankers Association or not, were admitted to the Board (Art. 2, Covenant Relating to the Joint Reserve Board of the Shanghai Bankers Association). Upon their becoming members, banks were required to deposit any of the following kinds of properties, which were to constitute the reserve properties of the Board:

(a) Real estate, situated within the limits of the International Settlement and of the French Concession in Shanghai;[19]
(b) Readily marketable commodities, such as silk, silk cocoons, cotton, cotton yarn, piece goods, foodstuffs (Regulations Governing the Appraisement Committee of the Joint Reserve Board, Art. 2);
(c) Bonds and stocks quoted in Shanghai, London or New York, as well as deposits with banks abroad;
(d) Gold coins and gold currencies redeemable in gold or gold bullion;

[19] The reason for this limitation was explained by the fact that these properties were considered as first class security; moreover, properties in Greater Shanghai were upset by the military operations on that occasion (1932).

(e) Securities other than those mentioned in the four preceding sections, but approved by the executive committee of the Board (Art. 7).

These properties were divided into two classes: namely, permanent reserve properties, which could not be withdrawn except in case of dissolution of the depositing bank, and ordinary reserve properties, which could be withdrawn upon a week's notice and approval by the executive committee of the Board (Art. 9). In the event of depreciation in the market value or deterioration of the reserve properties, the member banks were required to make further deposits in order to maintain the reserve unaltered in value; in default of this, the Board had the right to dispose of the properties at market value (Arts. 8, 23). Upon deposit of these reserve properties, the Board issued custody receipts and delivered to the member banks three kinds of notes and certificates in the following proportions, up to 70 per cent of the total value of properties as estimated by an appraisement committee appointed by the Board:

(a) Joint Reserve notes: 40 per cent
(b) Joint Treasury certificates: 20 per cent
(c) Securitv certificates: 40 per cent

Upon decision of the executive committee of the Board, security certificates could be replaced by Joint Reserve notes or Joint Treasury certificates (Art. 14). Joint Reserve notes were issued for amounts of CN$500, CN$1,000, CN$10,000 and CN$100,000 and were admitted into circulation in lieu of cash; they were redeemable in cash at the office of the Board, which could in turn redeem them at the issuing bank. A sinking fund was maintained for this purpose by the Board (Arts. 16, 18). Joint Treasury and Security certificates were admitted as security reserve against notes issued by the banks with privilege of note issue (Arts. 19, 21); other member banks were permitted to apply to the banks of issue for bank notes by depositing 60 per cent in cash and 40 per cent in Joint Reserve certificates, which could, however, be redeemed in cash upon thirty days' notice (Art. 20). The legality of this regulation became doubtful after the currency reform of 1935, but the practice was retained. Security certificates were acceptable by member banks as security for loans (Art. 21).

Fundamentally, the operations of the Board were those of

a trustee. The Board also acted, however, as an intermediary for the distribution of call loans among the banks; originally the Board could not grant loans directly to the banks, but was authorized to receive all the applications from the borrowing banks and pro-rate the amount among the lending banks (Art. 5, Regulations Governing Call Loans of the Joint Reserve Board). This limitation was lifted afterward, however, so that the Board could make call loans directly to the member banks. The term of the call loans was fixed at one day; they were granted on the security of Joint Reserve notes and at interest settled once every month (Arts. 4, 6-8). The Board deducted 1 per cent from the interest accruing from call loans to defray its expenses and to provide a sinking fund (Arts. 18, 25, Covenant; Art. 8, Regulations Governing Call Loans).

The introduction of this intermediary agent resulted in an important mobilization of funds. At the end of 1932 the reserves deposited with the Board amounted to CN$53.7 million. Real estate represented 85.5 per cent of the total, securities 14.4 per cent and the balance consisted of commodities and bullion. A sinking fund of CN$10 million was provided. At the end of 1936 the total properties were valued at CN$60 million, the distribution being substantially the same: 83.0 per cent in real estate, 11.75 per cent in foreign bonds and stocks, 5.0 per cent in domestic Government bonds and 0.25 per cent in cash. The certificates issued against properties deposited as security, as of June 30, 1936, represented 60 per cent of the appraised values. The appraisement committee of the Board followed a very conservative policy, writing down the property values and keeping a safe margin in the issue of certificates. The amount of call loans secured by Joint Reserve notes amounted only to CN$2.7 million in 1934, but rose to CN$128.3 million in 1935 and to CN$101.2 million in 1936. The Board had, therefore, become an important stabilizing element in the market, effectively performing functions which in other countries were traditional aspects of the rediscounting and credit policy of the central bank.

Negotiability of Bank Assets. The Shanghai Bankers Acceptance House, a subsidiary organ of the Joint Reserve Board, was inaugurated on March 16, 1936 "with a view to promoting the business of discounting of bills of exchange among banks in order to facilitate the development of agriculture, industry

and commerce" (Art. 1, Regulations Governing the Bankers Acceptance House of the Joint Reserve Board of the Shanghai Bankers Association). Admission to the Acceptance House was restricted to the members of the Joint Reserve Board and of the Clearing House (Art. 5). Admission fees ranged from CN$300 to CN$1,000, and the members were also required to pay a share of the reserve fund for the acceptance of the bills (Arts. 7, 8). The member banks were made responsible for the acceptance business of the House in direct proportion to their share of reserve fund. No member bank could withdraw from the House, unless it gave definite reasons and received the consent of the member banks of the Joint Reserve Board (Arts. 3, 4, 9, 10). Bills acceptable were limited to those issued by member banks as drawers and to those issued on the security of the following properties or commodities deposited with the House (Art. 18):

(a) Native products, as decided upon from time to time by the executive committee of the Joint Reserve Board. In 1937, the products eligible as security against bills were rice, wheat, flour, cereals, raw cotton, cotton yarn, domestic cotton textile, sugar, silk cocoons, raw silk, tea, domestic leaf tobacco, coal, iron ore and paper;
(b) Domestic commercial bills and promissory notes, and commercial bills arising from foreign trade, endorsed by a member bank, with terms not exceeding ninety days from the date of the transfer to the House;
(c) Government bonds, stocks of limited companies other than member banks and debentures having a market value;
(d) Land and buildings situated in the Municipality of Shanghai, yielding a fixed income ascertained in advance of transference;
(e) Other commodities and properties approved by the Executive Committee of the Joint Reserve Board.

Bonds, stocks and debentures could not exceed 50 per cent and real estate could not exceed 25 per cent of the total value of properties deposited for acceptance; the amount of bills accepted could not exceed 75 per cent of the appraised value of these properties; the date of maturity of bills accepted by the House was limited to ninety days from the date of the issue (Arts. 19, 21, 22). The bills accepted by the House could be discounted by the Joint Reserve Board or in the market and, in case of necessity, rediscounted at the Central Bank of China, the Bank of China or the Bank of Communications, at the request of the issuing bank (Arts. 25-27).

The House began operations early in April 1936. The re-

serve funds subscribed by member banks totaled CN$7.6 million, of which 5 per cent was paid in cash and the balance was in the form of deposits in the member banks in proportion to their respective subscriptions. The aggregate amount of bills which the House was authorized to accept was fixed at CN$30.5 million, to be allocated among the members according to their capital and reserves. The total properties deposited with the House as security for acceptance of bills amounted in December 1936 to CN$3.9 million, of which 50.0 per cent was in Government bonds, 20.7 per cent in real estate, 18.1 per cent in domestic commercial bills and promissory notes, 6.5 per cent in Joint Reserve notes and certificates and 4.7 per cent in native products. Eighty-four bills totaling CN$4.0 million were accepted during the months from April to December 1936; the greater number matured in ninety days. Total acceptances discounted amounted to CN$6.7 million; of this sum, 69 per cent was discounted by the Joint Reserve Board and the remainder by member banks. The object of the Joint Reserve Board was the mobilization of slow assets and the transformation of those assets into call loans; the chief concern of the Acceptance House, on the other hand, was the introduction of a negotiable instrument, freely accepted in the market. In both cases the assets behind the paper were essentially "slow," but by means of call loans or acceptances the elasticity of bank resources was increased.

Creation of a Domestic Investment Market. The China Development Finance Corporation was created by the banks with the aim of developing a domestic investment market. The Corporation was established in June 1934, "to study the worth of any business proposition, and, if it is found suitable, to arrange for the subscription of capital, Chinese and foreign, both singly and jointly, and later to follow through the development of the particular enterprise on behalf of those financially interested" (Memorandum of Constitution). The capital of the Corporation was fixed at CN$10 million, and was subscribed by the Central Bank of China, the Bank of China, the Bank of Communications, the Kincheng Banking Corporation, the China and South Sea Bank, the Shanghai Commercial and Savings Bank, the National Commercial and Savings Bank, the National Industrial Bank of China, the Young Brothers Banking Corporation, the Land Bank of China,

the Commercial Bank of China, the Continental Bank, the Kiangsu-Chekiang Commercial and Savings Bank, the Ningpo Commercial and Savings Bank, the Tung Lai Bank, the Manufacturers Bank of China and the China State Bank. Thus all the largest institutions were represented, but the moving spirit behind the organization was the Bank of China, traditionally the head of all Chinese banking syndicates.

The assets of the Corporation, which amounted to only CN$12.6 million at the end of 1934 and CN$14.8 million at the end of 1935, jumped to CN$115.0 million by the end of June 1936. The extraordinary increase in six months was due to the increase of more than CN$90 million in loans made on behalf of syndicated banks and in accounts receivable; partial repayment of these loans produced a contraction in the assets to CN$68.9 at the close of 1936. In effect the Corporation, with its capital of CN$10 million, could not pursue any extensive investment policy; its role, therefore, soon became that of an intermediary agent between the banks and the investment field.

The largest share of the loans made by the Corporation on behalf of banking syndicates was for railway construction. Bank loans to the Ministry of Railways were arranged by the Corporation for building purposes, and the syndicated banks were asked to give a guarantee for the credit obtained from foreign firms (German, Czechoslovakian, British, Belgian and French) for purchase of railway materials. By this intermediary intervention of the modern banks, the flow of foreign capital for railway development was revived after 1935 on a wholly businesslike basis. A similar intermediary policy was followed by the Ministry of Communications to finance public works and by municipal authorities to finance public utilities. In both instances the Corporation arranged credit facilities from Chinese and foreign sources in the form of long-term loans or middle-term advances. The Corporation's direct loans were for relatively short-terms, generally for the purpose of beginning construction works before general agreement for a bank loan was concluded. The amount of direct loans on June 30, 1936 was CN$3.7 million; in addition, CN$1.5 million was invested in securities. Liquid funds of the Corporation were kept in short-term paper of the Ministry of Finance.

Three other investment aspects of the Corporation were

especially important. The first was the market issue of Government railway bonds in collaboration with foreign finance companies. In May 1936 the China Development Finance Corporation and the Chinese and British Finance Corporation (a subsidiary of the Hongkong and Shanghai Banking Corporation) jointly issued the 6 Per Cent Shanghai-Hangchow-Ningpo Completion Loan of £1 million, on the security of the revenue of a section of the railway already in operation. The second was the introduction of long-term Chinese private bonds in the investment market. In August 1936 the Corporation issued ten-year debentures of the Wing On Company of Shanghai, for the amount of CN$5 million, at an interest rate of 7 per cent and on the security of real estate and machinery belonging to the Wing On Company and Wing On Textile Manufacturing Company. The third operation was the promotion of new undertakings. In December 1936 the Corporation subscribed the majority of the capital for the construction of a railroad from Chungking to Chengtu; the minority shares were subscribed by the National Ministry of Railway and the Szechwan Provincial Government.

The Extension of Agricultural Credit. The Agricultural Credit Administration was formally inaugurated on July 1, 1936 and actually organized in the form of a corporation in September 1936 under the auspices of the Ministry of Industry. The Administration received a capital fund of CN$30 million from the Government and a circulating capital of the same amount from the Government and private banks. Its management was entrusted to thirteen directors, seven appointed by the Government and six elected by the banks. A general manager and various deputy managers were designated by the Government. The object of the Administration was "to regulate agricultural products and to facilitate the flow of agricultural capital, thereby promoting the rural development of the entire country." Specifically, the Administration was entrusted with:

(a) The establishment of agricultural banks, agricultural cooperative societies and pawnshops in villages and districts;
(b) The extension of small loans to peasants, through the agricultural banks or cooperative societies;
(c) The regulation of agricultural production and marketing, and the establishment of public granaries whenever and wherever necessary.

All losses incurred in these operations were to be borne by

the Government. The operations of the Administration during the first half of 1937 were limited to preparing the ground for future activity. Most of the original undertakings were located in coastal regions.

Establishment of a Credit Information Service. Credit Information was most inadequate and unsatisfactory until the early 'thirties, when the Bank of China and the Chekiang Industrial Bank took the lead in setting up the Bankers Co-operative Credit Service in Shanghai, which soon received support and co-operation from a large number of banks.

Promotion of Research. To foster scientific banking research, Shanghai banks established the Institute of Banking, a well equipped organization, housed in the building of the Shanghai Bankers Association. Associations of bankers in other cities (for instance in Hankow) organized banking courses for apprentices and clerks.

TABLE 19

ASSETS AND LIABILITIES OF ALL MODERN BANKS

1932–1935

(In thousands of national yuan)

	1932	*1933*	*1934*	*1935*
Assets				
Cash on hand	279,621	311,759	282,609	412,509
Loans, discounts, overdrafts	1,857,406	2,327,087	2,606,902	3,185,424
Investments	226,408	256,901	466,212	593,429
Bank premises	89,131	105,157	122,291	138,886
Other assets	45,149	61,446	77,141	76,780
Reserves against notes in circulation	450,485	528,273	619,347	861,799
Reserves against notes issued for account of other banks	54,938	66,874	120,403	159,682
Liabilities				
Paid-up capital	214,900	250,835	334,190	368,465
Reserve funds	61,012	77,437	75,709	78,729
Deposits	2,115,667	2,594,130	2,981,377	3,779,418
Drafts issued	22,330	27,618	42,797	65,737
Other liabilities	43,355	61,293	74,463	66,865
Net profits	29,082	32,283	38,635	36,424
Notes in circulation	451,590	535,191	622,522	867,984
Notes issued for account of other banks	65,202	78,710	125,212	164,887
Total Assets/Liabilities	3,003,138	3,657,497	4,294,905	5,428,509

Note: This table is incomplete, as a number of banks usually failed to issue year-end statements of condition. For example, the combined balance sheet for 1933 includes 126 reporting banks out of 159 institutions in existence at the end of that year, and the combined balance sheet for 1935 includes 148 reporting banks, out of 163 institutions in existence at the end of that year. See also note to Table 9.

Source: *The Chinese Bankers Yea rbook*, 1936.

MODERN BANKS, 1927-1937: SUMMARY

Total Resources. The development of modern banks during the ten year period from 1928 to 1937 was extremely rapid; 124 new banks were established, while only twenty-three went into liquidation. Thus by 1937 there were 164 modern banks, and these had 1,597 branches. During this period, the paid-up capital of the member banks of the Shanghai Bankers Association rose from CN$117.0 million to CN$280.4 million; between 1932 and 1937 the total capital of all modern banks increased from CN$214.9 million to CN$434.3 million. The changes in the balance sheet of the modern banking system (including Government, local official, commercial, savings, special and overseas institutions) between 1932 and 1935 are shown in Table 19, opposite.

Concentration of Resources. Banking resources appeared to be heavily concentrated. The National Government held a share of CN$145.8 million in the capital of ten modern banks with aggregate capital of CN$186.4 million and aggregate resources of CN$3,459.6 million. These banks held about 49

TABLE 20

NATIONAL GOVERNMENT HOLDINGS IN MODERN BANKS

December 31, 1935

(In thousands of national yuan)

	Paid-up capital	*Government share*	*Percent of total capital*	*Total resources*
Central Bank of China	100,000	100,000	100.00	931,543
Bank of China	40,000	20,000	50.00	1,385,829
Bank of Communications	20,000	12,000	62.50	646,163
Farmers Bank of China	7,200	2,500	33.20	137,478
Manufacturers Bank of China	5,000	1,010	20.50	53,786
National Industrial Bank of China*	4,000	3,500	87.50	106,689
Ningpo Commercial and Savings Bank*	4,000	3,750	93.75	94,244
Commercial Bank of China*	4,000	2,950	73.75	99,509
Frontier Rank	2,000	50	2.50	4,389
Peiping Agricultural and Industrial Bank†	200	50	25.00	.....

* In 1935 these three banks obtained advances of CN$5 million each from the National Government, but they were reorganized in 1937, with a new capital of CN$4 million, consisting of 15 per cent of the former capital and the remainder in Government bonds. In the case of the Nationa Industrial Bank of China, the National Government originally held a share equal to CN$60,000 (or 1.95 per cent of the capital). Data for the Ningpo Commercial and Savings Bank were included in the statement of conditions for all banks in 1935; data for the other two banks were excluded. The data given above for the National Industrial Bank of China and for the Commercial Bank of China cover the situation at the end of 1934. † The Peiping Agricultural and Industrial Bank was established in 1935 and no statement was published for that year.

per cent of the total capital and 61 per cent of the combined resources of all banks.

The National Government also controlled the collection of savings through other sources. This was done directly through the Postal Remittances and Savings Bank, which at the end of 1935 had assets of more than CN$61 million. In addition, the Government had indirect control of the Central Trust of China and the Central Savings Society, subsidiaries of the Central Bank of China, and the Sin Hua Trust and Savings Bank, the largest savings bank of China, controlled by the Bank of China. The China Development Finance Corporation also came under the supervision of the Government through the participation of the Government banks: the chairman of the Corporation was both Minister of Finance and governor of the Central Bank of China.

This concentration of banking resources under public initiative was fundamentally the result of the forms of state capitalism adopted by the National Government in the policy of economic modernization. Its first Minister of Finance, Dr. T. V. Soong, had made the concentration of national resources under Government direction one of the bases of his reconstruction program. It should also be added, however, that banking in China was traditionally a public function, and public control of credit was one of the postulates of the social and political philosophy of Sun Yat-sen.

In addition to the Government concentration, there was also considerable concentration of resources among a limited number of private banks, as may be seen in Table 21.

TABLE 21

CAPITAL AND RESOURCES OF THE "SEVEN LEADING" PRIVATE BANKS

December 31, 1935

(In thousands of national yuan)

	Capital	*Total resources*
Shanghai Commercial and Savings Bank	5,000	212,236
Kincheng Banking Corporation	7,000	172,291
China and South Sea Bank	7,500	148,732
Continental Bank	3,791	137,444
Yien Yieh Commercial Bank	7,500	124,908
National Commercial Bank	4,000	108,589
Chekiang Industrial Bank	2,000	66,343
Total	36,791	968,543

Source: Annual Reports of the banks.

These seven banks held 10 per cent of the combined capital and 17 per cent of the total resources of all modern banks. A group of nine other middle size institutions with resources above CN$10 million each had combined resources totaling CN$269 million, or 5 per cent of the aggregate resources of all banks.

This public and private concentration was on a national scale, chiefly because of the central political control and the extension of activities to more than one province. But public control was also established over local institutions, through the local official authorities, as indicated below:

	Total resources (in thousands of national yuan)
Provincial banks, provincial farmers bank, provincial reconstruction banks, municipal banks	472,257
Hsien agricultural and industrial banks	2,346
Total	474,603

This last group includes thirty-four banks under the control of provincial, municipal and district authorities. They held 9 per cent of the total resources of the modern banks. It could not be established to what extent this group was under the control of the National Government, since central control over these banks depended upon its political control of local authorities.

In conclusion, it appears that, among 148 banks reporting at the end of 1935, a group of ten banks with National Government interests, sixteen private banks and thirty-four banks with local political interests held 92 per cent of the total banking resources of the country. This indicates that the other 88 reporting banks, or 59.5 per cent of the total number, held the balance of the resources, or only 8 per cent. It is not known to what extent these minor banks were under the control of larger institutions.

As specialization was only slightly advanced, each bank, regardless of its origin and official functions, transacted many types of banking business. Specialization was apparent only in the farmers' and provincial banks, this being due to their limited area of operations and political connections rather than to the selectivity of their business. In general, commercial loans on commodities deposited in go-downs and industrial loans based on factory, machinery or land mortgages repre-

sented the largest share of bank assets. These loans were fundamentally illiquid, and since deposits were mostly in the form of current accounts, a dangerous situation existed. A policy was pursued, therefore, of increasing savings and fixed deposits, while in Shanghai co-operative efforts were made through the Joint Reserve Board and the Bankers Acceptance House in order to mobilize the slow assets and to create a market of liquid funds. This policy adopted in Shanghai had a general influence upon the whole country, due to the extension of the branch system. Efforts were also made through the China Development Finance Corporation to introduce long-term industrial financing in the form of debentures issued in the market. This type of security had previously been limited to Government issues.

With regard to the territorial distribution of banking, concentration in a few money market centers was apparent. At the end of 1935, the total number of modern banks was reported at 164, with 1,332 branch offices.[20] Shanghai alone had fifty-eight head offices, or 36.5 per cent of the total number of banks, and 124 branch offices, or 9 per cent of all branches. Eight major cities, including Tientsin, Peiping, Tsingtao, Hangchow, Nanking, Chungking, Hankow and Canton, had a total of forty-one head offices, or 25 per cent of the total number of banks, and 262 branch offices, or 20 per cent of all branches. In addition, the provinces of Kiangsu and Chekiang (excluding Shanghai, Nanking and Hangchow) had thirty head offices and 285 branches. The rest of the country had thirty-five head offices, or 21 per cent of the total number of banks, and 600 branch offices, or 45 per cent of all branches.

This shows that bank facilities in 1936 were still very meager in the interior of China. It is also true that there was only scanty business for banks in the hinterland. The native banks limited themselves to financing trade; agriculture never relied on banks for credit, and the farmers were in no position to supply the security required by the banks. The need was felt, particularly after 1930, for an intermediary organization between the banking system and the farmer, when agriculture passed through a most serious plight with a decline in prices and a depletion of the monetary resources of the rural com-

[20] In addition to the four Government banks, there were twenty-five provincial and municipal banks and 135 ordinary banks.

munity. This new intermediary organization was found in the co-operative system.

THE RURAL CO-OPERATIVE CREDIT SYSTEM

The growth of the co-operative system was greatly fostered by the National Government. Before 1927, the only local co-operative societies were in Hopei Province, organized by the China International Famine Relief Commission. This Commission was an international nonpolitical and nonsectarian body, administered by Chinese nationals and foreign residents. Its purpose was to prevent famine and to promote reconstruction where famine occurred. It was formed in 1921, as a result of the amalgamation of various local committees in charge of the distribution of foreign relief funds. Its original capital was made up of a balance of over CN$2 million, which had remained unspent in the 1921-22 relief campaign. Under exceptional circumstances, appeals were being made to foreign countries, but the normal working fund of the commission was formed by the income from unspent balances, by grants from provincial Governments, by other contributions (as those from Boxer Indemnity Funds) and by gifts.

In 1928 the National Government appropriated CN$50,000 for publicity work on co-operation, as a tangible application of the social philosophy of Sun Yat-sen. Greater development, however, came when co-operative societies were planned as a rehabilitation measure in the campaign against the Communists. In 1932 the Finance Relief Bureau of the Military Headquarters for Communist Suppression at Nanchang (Kiangsi) started organizing societies in the recovered districts, and in 1933 the same Bureau promoted the establishment of the Four Provinces (Hunan, Hupeh, Anhwei and Kiangsi) Agricultural Bank, one of the principal purposes of which was the establishment and financing of co-operative societies. Other banks and institutions came into the field in following years, and in 1935-37 there was a mushroom growth of agencies, private and public, national, inter-provincial, provincial and local, to organize and finance co-operative societies. By the end of 1935, 26,224 societies were registered with the *hsien* (district) authorities, as compared with 9,948 in 1934, 2,763 in 1932 and 584 in 1928. Of that number, 59 per cent were classified as credit societies and 16 per cent as "integrated"

societies, organized for general (and credit) business. Out of one million members enlisted in all co-operatives, 42 per cent belonged to credit and 20 per cent to integrated societies. The development, however, was limited principally to central and northern China, as indicated by the distribution of credit and integrated societies by provinces, at the end of 1935.

TABLE 22

CO-OPERATIVE SOCIETIES AND MEMBERSHIP IN 1935

		Societies	*Membership*
Suyan	(a)	54	1,115
Kansu	(a)	32	2,105
Shensi	(a)	513	19,301
	(b)	13	6,606
Shansi	(a)	440	2,453
Hopei	(a)	4,830	106,015
	(b)	751	13,707
Shantung	(a)	1,087	26,293
	(b)	381	9,408
Kiangsu	(a)	1,731	45,779
	(b)	1,356	42,265
Anhwei	(a)	2,060	61,410
	(b)	66	3,719
Honan	(a)	610	30,334
	(b)	941	54,335
Hupeh	(a)	781	28,350
	(b)	360	29,350
Hunan	(a)	892	28,475
	(b)	3	141
Kiangsi	(a)	1,113	34,858
	(b)	79	34,815
Chekiang	(a)	945	25,267
	(b)	281	11,759
Fukien	(a)	234	8,097
	(b)	74	3,419
Kwangtung	(a)	53	2,411
	(b)	65	4,713

(a) Credit societies. (b) Integrated societies.

Source: National Agricultural Research Bureau, *Monthly Crops Reports*, February 15, 1936.

Co-operative societies were regulated by the Co-operative Law, promulgated during March 1934 and made effective as of September 1935. With a view to placing them on a safe financial basis, Article 20 provided that "after making good accumulated deficits and paying interest, 20 per cent of the profit should be put to a reserve fund; at least 10 per cent should be deposited in a common benefit fund and 10 per cent should be distributed among the directors and staff as bonus." According to the democratic principles of co-operation,

every member was granted only one vote at meetings (Art. 47). No uniform rule of registration was provided. The co-operative societies were permitted to receive time deposits from members at an interest rate higher than that ruling in the market, and to extend productive loans to members at an interest rate lower than that current in the market (Art. 3). The maximum nominal value of a co-operative share was fixed at CN$20. Co-operative societies were exempted from income and business taxes (Art. 6).

However, a spontaneous co-operative movement failed to develop and the societies remained dependent upon other institutions, both for organizing and financing. Of the societies existing at the end of 1935, 78 per cent had been organized by *hsien* authorities, 4 per cent by provincial Governments, 7 per cent by the China International Famine Relief Commission, 1 per cent by banks and the rest by educational and economic institutions. A standard grading system was set up by the China International Famine Relief Commission, which trained organizers of mutual aid societies among farmers; these societies were eventually put on a co-operative basis. The Commission also took other societies under its control, and all of these were divided into two large groups, recognized and unrecognized societies; recognition presented the possibility of obtaining credit from or through the Commission. The recognized societies were again graded into five groups, from A to E, on the basis of an efficiency standard.

At the end of 1935, the condition of the co-operative societies under the direction of the Commission was as follows.

TABLE 22A

CONDITION OF CO-OPERATIVE SOCIETIES UNDER THE C.I.F.R.C

December 31, 1935

(Money figures in national yuan)

	Total number	*Recognized societies*	*Membership*	*Paid-up capital*	*Reserves*	*Deposits*	*CIFRC loans*
Hopei	2,613	919	54,567	140,492	20,941	143,395	691,800
Anhwei	3,826	949	103,709	209,583	..	22,728	534,138
Kiangsi	940	781	30,107	72,071	5,959	17,537	536,813
Hupeh	766	380	13,984	14,030	..	410	202,282
Hunan	794	543	14,484	46,627	..	5,921	..
Total	8,939	3,573	186,851	482,808	26,890	192,681	1,965,133

Source: China International Famine Relief Commission, *Annual Report*, 1935.

As indicated by this table, co-operatives were financed mainly from the outside. The capital was raised through membership shares, which had a value of CN$2-CN$5. Reserves were practically nonexistent and deposits did not play an important part, because the societies had not obtained widespread confidence among people. The capital represented 7.3 per cent of total resources of these societies, the reserves 1.1 per cent, other funds in deposits 8.2 per cent and loans from the Commission 83.4 per cent.

In financing operations, the Commission acted both directly and as an intermediary. In 1931 it entered into an agreement with the Shanghai Commercial and Savings Bank, which set aside a fund of CN$20,000 for loans to co-operative societies recognized by the Commission. In 1932 the fund was increased to CN$50,000, and in 1933 a collective fund was subscribed by the Shanghai Commercial and Savings Bank, which contributed CN$100,000, and by the Bank of China and Kincheng Banking Corporation, which contributed CN$50,000 each. This fund was used for loans to co-operative societies recognized by the Commission and graded A to C; the banks charged the Commission with an interest of 8 per cent and the societies paid the Commission an interest rate of 10 per cent.[21] The condition of these societies cannot, however, be taken as fully representative, not only because they were supposed to be administered best, but also because they were frequently used as relief institutions.

In 1935 the Commission was financing, either directly or through banks, about 16 per cent of the co-operative societies in Hopei, Anhwei, Kiangsi, Hupeh and Hunan. The unrecognized co-operative societies and those not under the direction of the commission were financed as shown on page 193.

At the end of 1935 banks were financing about half of the co-operative societies, either independently or jointly. In an attempt to co-ordinate the loan policy among the banks and also to avoid conflict, a joint banking syndicate was formed in 1934 by five banks; namely, the Shanghai Commercial and Savings Bank, the Bank of Communications, the National

[21] China International Famine Relief Commission, *Annual Report,* 1931, p. 35; 1933, p. 18.

	Per cent of all societies	
Hsien Governments	2.1	Shantung, Hopei, Kiangsi, Chekiang, Fukien, Honan
Hsien farmers' loan offices, *Hsien* farmers' banks	19.1	Shantung, Shansi, Anhwei, Honan, Chekiang
Provincial co-operative commissions and co-operative unions	17.3	Suyan, Hopei, Hunan, Kiangsi, Fukien, Kwangtung, Honan, Shensi
Provincial farmers' banks	12.3	Kiangsu
Farmers Bank of China	12.8	Anhwei, Hupeh, Hunan, Chekiang, Fukien, Shensi, Kansu, Kwangtung, Honan
Bank of China	7.4	Hopei, Shantung, Anhwei, Chekiang, Honan, Shensi
Shanghai Commercial and Savings Bank	3.5	Shangtung, Kiangsi, Anhwei, Chekiang, Kwangtung
Other banks (Kincheng Banking Corporation, Bank of Communications, Hopei Provincial Bank, Provincial Bank of Chekiang, etc.)	5.2	Suyan, Hopei, Shantung, Kiangsu, Chekiang, Shensi
Native banks, money changers, other shops	1.3	Shensi, Hopei
Other (money lenders, etc.)	3.0	Shansi
Total	84.0	

Source: National Agricultural Research Bureau, *Monthly Crops Reports*, February 15, 1936.

Commercial Bank, the Kincheng Banking Corporation and the Four Provinces Agricultural Bank. Later on, five more banks joined, but the Four Provinces Agricultural Bank withdrew, following its reorganization as the Farmers Bank of China. In May 1936, a common fund of CN$2.5 million was subscribed and a territorial allotment was agreed upon by the nine banks. In addition at the end of 1936, the Kiangsu Farmers Bank controlled more than 2,000 co-operative societies, which had received credit therefrom amounting to CN$24.0 million. The Farmers Bank of China controlled nearly 3,000 co-operative societies, scattered in various provinces, in which it had invested CN$4.5 million. The Bank of China had also invested over CN$2 million in co-operative societies, especially in Anhwei. The total amount of co-operative investments from banks outstanding at the end of 1935 was estimated at CN$10 million.[22]

Credit co-operative societies were considered, in accordance with the Raiffeisen system, as necessary intermediaries for

[22] *Far Eastern Survey*, March 31, 1937.

granting credit to farmers. However, the expansion of banks into the co-operative field was looked upon with distrust by the social reformers, who considered the co-operative development a panacea for all Chinese ills and the solution of the rightist and the leftist tendencies of the political parties.[23] The fact that banks lending to the co-operatives required collateral, either in the form of commodities deposited in a go-down or in the form of land security, granted collectively from the members, was considered by a western co-operative expert as a fact contrary to the "spirit" of the co-operative system. In his words, banks "treated rural credits as though they were urban credits," and failed to "rely on the community spirit, the readiness of each individual farmer to fulfill his obligation in the common interest, which is the real security offered by a co-operative group."[24] The same writer, however, realized the peculiar structure of the co-operative system in China. The societies were formed from the top to the bottom, and in consequence the "spirit of community" was even less evident than in European co-operatives. Moreover, this collective system was planned chiefly as a preventive relief measure or as a political method, and default in payment of loans at the date of maturity occurred frequently. In not a few cases the co-operative society was taken over by local merchants and wealthy people, who diverted co-operative money to loans to farmers at the traditional usury rates and often entered into legal controversies with the banks over the use of funds.

Evidently, there was a necessity of concentration in consti-

[23] The Chinese Soviet Republic, in its wanderings from province to province, spread the idea of co-operation under public initiative and control. At the end of September 1933, when the Soviets were established in the territories from Kiangsi to Szechwan, there were 1,423 officially established Soviet co-operative societies, with a total capital of CN$305,551. Credit societies were of little importance as compared with consumption and food societies. After that time, the Soviet Chinese Republic suffered serious setbacks and moved to northwestern provinces (Kansu, Shensi). No other information is available. Mao Tse-tung, *Report on the Progress and Achievements of the Chinese Soviet Republic at the II Chinese National Congress at Juikin, Kiangsi, January 22, 1934,* London, 1934, p. 28 ff.

[24] F. Strickland, *The Co-operative Movement in China,* pp. 38-9. In the opinion of Chen Han-seng, the intervention of the banks substituted "collective usury for individual usury," and "co-operatives have accelerated the process of commercialization of agriculture—a process which under the present Chinese system of agrarian relations can only intensify the misery of China's peasantry." Chen Han-seng, "Co-operatives as a Panacea for China's Ills," *Far Eastern Survey,* March 31, 1937.

tuting good societies, based upon co-operative spirit and principles. However, this point should not be stressed beyond reasonable limits. Co-operation, even imperfect and almost compulsory, may succeed in developing the social spirit of its members and bring about a real understanding of common interest and action. It can be a good method for solving practical problems, deriving from calamities, civil war and other circumstances. It can be useful in fighting against usury practices. In general, organization was not prevalent among co-operative societies, with the exception of district unions patronized by the China International Famine Relief Commission, and their strength, therefore, was inadequate to their task. The benefit derived from bank intervention was not any social or political reforming; in a limited way, through a form of collective security, a small part of the funds which flooded the coast after 1931 were returned to the interior at a somewhat lower rate of interest. The banks, by granting loans to the co-operatives at interest rates of 8 to 10 per cent a year, enabled the co-operatives to finance their members at monthly rates of 1.1 to 1.4 per cent, which was considerably lower than the prevailing rates for such advances.

However, the distribution of the co-operative loans in four provinces of Central China (Anhwei, Hupeh, Honan and Kiangsi) for the years 1933-35 indicated that in effect the system was limited to the landlords, who even before were in a position to obtain loans at the lowest rates from other sources.

	Owners	*Part-owners*	*Tenants*
Average amount of credit obtained from co-operatives	CN$16.10	CN$11.20	CN$7.30
Percentage of the total credit obtained	52	35	13

Source: Nan Ping-fang, *A Practical Study of Rural Credit in Four Provinces of Central China*, Nanking, 1936.

Moreover, the loans granted by co-operative societies usually had a maximum term of one year and were repayable any time in advance of that date. As a result, they could not be invested in development projects, but were actually used to finance the usual cycle of production. The only exceptions were the co-operatives financed directly by the China International Famine Relief Commission, which, having relief funds at its disposal, could allow more liberal terms. Last, but not least, the amount of co-operative credit was altogether insignificant. In 1933-35, it was estimated that the credit distributed by agricultural co-

operatives represented only 1 per cent of total agricultural credit and was granted to only 5 per cent of the total number of borrowing farmers; the bulk continued to be granted by the traditional sources; namely money lenders, pawnshops, merchants and *hweis*.[25]

[25] Nan Ping-fang, *A Practical Study of Rural Credit in Four Provinces of Central China,* Nanking, 1936.

CHAPTER VIII

PROBLEMS OF BANKING AND CREDIT IN 1936-1937

THE MONEY MARKETS, 1936-1937

By the end of the first ten years (1928-37) of the National Government, China's three money markets had undergone extensive and far-reaching changes.

The Native Money Market. In 1936-37 the native money market was passing through a stage of liquidation. Ever since the crash of the Shansi firms in 1911, native banks had remained structurally weak. In a general way, it may be said that they did not fit into the progressive modernization of the country. They lacked central co-ordination and were living on speculative activities, such as the flow of call loans from foreign and modern banks and transactions on internal exchanges. With inadequate resources, their prestige depended upon the traditional solidarity of the guild system, but even this local organization was rapidly breaking down. In particular, native banks were forced out of business by the expansion of modern institutions.

It should be pointed out, however, that modern banks were limited to the largest cities and a few provinces, while native banking and non-banking firms continued to be the only local financial agencies in extensive sections of the country. Moreover, modern banks directed their attention to middle and large-sized enterprises, but they failed to establish sufficiently strong contacts with small traders and farmers. As a consequence, while native banks of the higher types suffered severely from the competition of the modern banks, other native credit institutions, such as small native banks, pawnshops, money lenders and *hweis*, were scarcely affected by the development of modern banks.

The Foreign Money Market. The position of control that foreign banks had over China's financial international relations in 1926-27 gave way in 1936-37 to a new position, which we may define as one of "necessary co-operation" with the Government banks. Foreign banks lost their absolute control

over costless or cheap resources, such as customs and salt revenues, foreign loan funds and foreign remittances, which amounted to fairly large sums and were employable at high profit. During 1936 and 1937 the Chinese Government banks directed their efforts toward absorbing commercial paper arising from foreign trade; with the nationalization of silver stocks and the accumulation of foreign balances in their hands, they took away from foreign banks the traditional privilege of being the money bags and the exchange brokers of the country.

Even in their new position, however, the foreign banks remained a decisive factor in the international financial position of the country. Besides holding large amounts of banking funds for account of Chinese capitalists, they continued to transact a considerable share of the foreign exchange business; they acted as representatives of foreign bondholders and were the intermediary agents for the inflow of foreign capital. Their co-operation was required, therefore, in any currency or credit policy to be adopted by the National Government. The attitude taken by some foreign banks with regard to the monetary reform of 1935 was one of active co-operation; other banks took a rather passive attitude; no bank, however, actively opposed the official policy. This was rightly considered an important element in the success of the reform. Last, but not least, foreign banks continued to enjoy extraterritorial rights and remained the normal institutions of foreign communities: these still were very important and required a most active foreign banking service.

The Modern Money Market. The growth of the number of institutions and the resources of the modern money market was uninterrupted and was accompanied by an extension of activities and territorial expansion. Great impulse came from the National Government, and official institutions expanded more rapidly than private firms. In contrast with the more liberal attitude of the former Central Government at Peiping, official intervention in the banking business was made a pillar of the financial policy pursued by the National Government at Nanking.

In 1937, the modern money market was a centralized structure, with resources concentrated in a few official and private banks. The branch system was widely used, although, due to the expanse of the country and the lack of communications,

bank offices were restricted to a relatively small number of cities and provinces. Co-operative societies and other non-banking institutions were controlled by official agencies and banks. Internally, modern banks were organized in departments, some of which (savings and trust) were set up under autonomous administration; inter-departmental relations, however, were not clearly defined. The principal business of the banks was in financing private industry and trade, and Government administration and enterprises. Real estate financing, which flourished before 1932, declined in later years. The securities on which loans were granted consisted of commodities and property deeds, rather than commercial paper; as a consequence the banks' assets were essentially slow (i.e., not readily cashable) and not in harmony with their liabilities, which were traditionally made up of current accounts. Successful efforts in 1935-37 contributed toward increasing the balance of fixed and savings funds, either deposited directly in the general department of the banks or collected through trust and savings departments and subsidiary institutions.

Inter-bank co-operation succeeded in mobilizing and commercializing a portion of the slow assets of the banks. The Joint Reserve Board and the Bankers Acceptance House fulfilled functions which in western countries were performed by central banks. Aside from aiming ultimately toward the introduction of new types of commercial paper, these organizations were immediately concerned with easing, by making short-term advances, the strain brought upon the banks by illiquid assets. Both organizations limited their operations to Shanghai. Nevertheless, due to the concentration of funds in the modern money market the other local financial centers were influenced through the branch system by the credit facilities granted to a few large banks.

On the whole, it may be said that in 1937 modern banks in general, and Government banks in particular, backed by expanding resources and the prestige gained through the successful currency and exchange management, appeared ready to assume the financial leadership of the country.

THE CREDIT STRUCTURE

A few points regarding China's credit structure in 1936-37 call for special attention.

Decentralization of Financial Resources. Despite the high concentration of funds in the largest modern banks, the financial resources of the country were widely dispersed, chiefly as a result of their distribution among three autonomous money markets (native, foreign and modern). Native banks with limited resources lacked central organs and national co-ordination. Foreign banks, with financial resources probably equal to those of the largest modern banks, a wide range of operations abroad, long experience and high prestige, acted individually and never developed means of banking co-operation and common policy. Even in the case of the modern money market, the number of institutions was far too large; too many of them were undercapitalized and structurally weak and these lacked the effective support of the central banks. They were, therefore, in a position not very different from that of the native banks. No co-ordination beyond clearing arrangements was ever attempted among the three money markets.

The Lack of a Commercial Paper Market. In the opinion of foreign banking experts, the most significant weakness of the Chinese credit system was the lack of commercial paper and the nonexistence of a bill market. As long as the credit rating of native banks was high, their cashiers' orders had represented important paper, freely accepted and circulated. The introduction into the market of drafts issued by modern banks did not compensate for the decline in importance of this native document. The traditional practice of granting credit on passbook (overdrafts) made borrowers generally reluctant to abide by new methods which appeared cumbersome in their procedure and rather tricky in their legal provisions. Moreover, the lack of reliable credit information discouraged most banks from engaging extensively in open market discount operations. As for rediscount, although provisions were made in the Law of the Central Bank of China and in the Covenant of the Shanghai Bankers Acceptance House, no actual practice of rediscounting was developed. This was due to the lack of commercial paper and to the reluctance of the merchants to have their notes circulated.

The Lack of an Investment Market. The third point was the lack of an investment market. Dealings in the stock market were limited to a small group of bonds and shares. Aside from debentures of local public utilities and real estate companies

registered under foreign laws, the attention of the operators was chiefly directed toward rubber shares (traded in Shanghai); Philippine gold mine shares (traded in Hongkong) and bonds of the National Government. The market activity was limited to a restricted group of speculators, without any important participation by the general public. New issues were not, as a rule, disposed of directly in the market; Government bonds were usually delivered to the banks as security for loans, and private shares became salable only when large dividends were distributed. The establishment of the China Development Finance Corporation represented a step toward bringing available funds and investing institutions into the capital market, and its early operations were a significant success. The creation of an investment market, however, remained in an experimental stage.

THE DISTRIBUTION OF CREDIT AMONG USERS

It is commonplace criticism that the modern money market grew by number of institutions and value of resources while making little progress in efficiency of banking operations. In order to appraise this criticism, it should be noted that after 1927 all three money markets existing in China passed through dynamic processes, in which their internal structure, as well as their external relations, underwent basic changes; in these processes there were necessarily inherent elements which may be considered defective. Specifically, observers pointed to the crowds of banking employees working at low efficiency and inept in handling western credit instruments. The growth of modern banking proceeded at a much more rapid pace than the progress in educational facilities and the development in the industrial and trading fields.

It is doubtful, however, whether efficiency should be basically connected with any specific methods, or rather with methods which harmonize with the various elements of the economic system. In fact, the choice of credit instruments and methods does not depend upon the banks—the credit producers—but ultimately falls upon industrialists, farmers and traders—the credit users of the community. The basic point in analyzing a banking system, therefore, should be whether or not it is developing types and instruments of credit which

satisfy the requirements of the various groups of borrowers; any proposals of reform and reorganization must be viewed on a similar basis. Thus, it is important to analyze here the distribution of credit in China in 1935-37 from the standpoint of the various private groups and political agencies borrowing funds in order to maintain and develop their activities.

The Financing of Rural Economy. The importance of the rural economy in China may be indicated by the fact that the Ministry of Industry classified 55.2 million households as "rural," out of a total of 77.5 millions covered by the incomplete census of 1932-33.[1] The assumption that the Chinese rural economy remained on a closed, non-monetary basis could not be supported by sufficient evidence. On the contrary, an investigation made by J. L. Buck for the years 1921-25, on 2,866 farms in seventeen localities of seven provinces, showed that an average of 52.6 per cent of the products raised by farmers was sold for cash; the variations were from a minimum of 31 per cent in Hopei province, for a bad wheat-crop year, to a maximum of 84 per cent for cotton crops in Chekiang province.[2] The sale of a portion of the crops for cash provided the farmers with the money required for purchases of foodstuffs and manufactured products and for payment of taxes and rent. The most common system of rent payment was, in fact, the "cash-crops," by which a definite quantity of grain or rice was to be delivered every year to the landlord, either in kind or in money. Opinions differed as to the amount of the cash-rent. According to J. L. Buck, the rent revenue of the landlord represented an annual interest of 8.5 per cent on the capital value of the land; however, this rate appears to be unusually low and may be due to an overvaluation of the capital value of the land. According to more recent investigations,[3] land investment produced average returns of 11 to 19 per cent, the minimum being around 8 per cent for first class waterfields in Kiangsu province and the maximum around 33 per cent for third class dry-fields in the interior. In the words of J. L. Buck, "This denotes a fairly commercialized agriculture, which

[1] Tao, M. H., "Population," *The Chinese Yearbook*, 1935-1936, pp. 115-131.

[2] Buck, J. L., *Chinese Farm Economy*, Chicago, 1930, pp. 196-292.

[3] *Monthly Crop Reports*, April 1934 and May 1935; Chen Han-seng, *Agrarian Problems in Southernmost China*, Shanghai, 1936, pp. 47-72; *China Industrial Handbook, Kiangsu;* Shanghai, 1933, p. 35.

in turn indicates that farmers had considerable need for ready cash to meet their various requirements."[4]

Commercialization of China's agriculture was not due exclusively or prevalently to ameliorations in communications and trade, to the introduction of mechanized equipment in farming and to other facts leading to territorial division of labor, rational specialization and increase of efficiency in farming methods. The basic cause which forced the peasants to increase their monetary receipts was want created by usury, taxation, extortions of many kinds, natural or social calamities. In fact, at the close of 1933, more than half of the farming population of China (73 per cent in Chahar, 41 per cent in Honan) was burdened by cash debts arising from consumption needs.[5] As shown by table 24A (p. 204), the individual money lender and the merchant were the primary sources of credit for the farmers, while banks and co-operative societies played a secondary part. These official statistics, comprehensive of all China, were confirmed by local investigations: between 1933 and 1935 the farmers of four provinces of central China (Honan, Hupeh, Anhwei and Kiangsi) obtained credit from the sources shown in table 23.

TABLE 23

SOURCES OF FARM CREDIT, 1933–1935

Sources	*Percentage of farmers borrowing*	*Percentage of credit obtained*
Money lenders	93.0	73.6
Mortgagors	19.0	17.0
Hweis	7.0	4.0
Pawnshops	13.0	2.0
Stores	23.0	2.0
Co-operatives	5.0	1.0
Commission firms	2.0	0.4
	162.0*	100.0

* Some farmers borrowed from more than one source.
Source: Nan Ping-fang, *A Practical Study of Rural Credit in Four Provinces of Central China*, Nanking, 1936.

The lack of adequate types of security is evident from the fact that half of the rural loans was advanced on unsecured credit and the other half was covered by mortgage or other real guarantee. Loans on mortgage were advanced by local money lenders up to 60 per cent of the value of the land.

[4] Buck, J. L., *op. cit.*, p. 197.
[5] *Monthly Crop Reports*, April, 1934.

TABLE 24A

RURAL FINANCIAL CONDITIONS IN CHINA, 1934: SOURCE OF CREDIT AND KIND OF SECURITY

			Source of credit (in per cent)									Kind of security (in per cent)		
			Institutional					Personal						
Province	No. of Hsiens reported	No. of cases of "Sources" reported	Banks	Co-operative societies	Pawn-shops	Exchange shops	Other shops	Land-lords	Well-to-do farmers	Mer-chants	No. of cases of "Security" reported	Unse-cured credit	Guaran-teed by others	Mortgage or other security
Chahar	6	16	—	—	—	12.5	18.7	25.0	12.5	31.3	14	14.3	42.9	42.8
Suiyan	11	34	2.9	5.8	2.9	8.8	5.8	20.7	17.7	35.4	25	12.0	36.0	52.0
Ninghsia	4	14	—	—	—	—	21.8	14.3	28.6	35.3	14	35.7	42.9	21.4
Tsinghai	5	47	—	—	6.3	—	14.9	23.5	17.0	38.3	38	10.2	39.5	50.3
Kansu	21	75	—	1.3	2.6	—	16.0	21.3	22.7	36.1	62	22.5	40.4	37.1
Shensi	42	286	4.1	2.0	9.0	5.0	20.5	15.4	14.4	29.6	103	10.6	37.9	51.5
Shansi	75	581	4.9	1.3	18.9	13.1	11.4	14.4	13.4	22.6	339	12.0	35.7	52.3
Hopei	105	1,424	3.3	11.9	5.1	10.7	13.8	13.2	19.8	22.2	872	21.1	35.2	43.7
Shantung	83	697	6.1	3.4	3.5	16.3	15.4	15.5	19.6	20.2	451	14.0	46.9	39.1
Kiangsu	47	499	8.8	5.6	18.5	6.2	7.2	23.5	14.2	16.0	300	22.6	32.6	44.8
Anhwei	33	184	—	8.6	6.9	0.5	13.1	30.4	16.9	23.6	155	23.8	35.5	40.7
Honan	63	368	1.7	1.3	6.3	6.5	15.7	28.8	16.6	23.1	252	10.3	46.0	43.7
Hupeh	25	102	2.9	4.9	10.9	3.9	13.8	25.4	21.6	16.6	80	25.0	31.2	43.8
Szechuan	67	409	2.6	0.9	18.3	6.8	8.8	26.6	14.5	21.5	313	20.4	35.1	44.5
Yunnan	34	114	2.6	0.8	5.2	—	6.1	33.4	21.1	30.8	73	6.8	31.5	61.7
Kweichow	21	67	—	—	7.4	—	10.4	32.9	23.9	25.4	49	18.3	22.5	59.2
Hunan	36	177	—	1.6	5.6	2.2	13.6	34.5	22.7	19.8	161	24.9	28.6	46.5
Kiangsi	27	125	1.6	3.2	5.6	4.0	11.2	33.6	22.4	18.4	101	32.7	24.5	42.8
Chekiang	46	265	3.7	4.5	16.2	10.1	12.0	21.9	15.8	15.8	167	26.3	26.8	46.9
Fukien	29	110	0.9	—	3.6	7.2	16.3	20.0	22.8	29.2	91	27.5	27.5	45.0
Kwangtung	49	305	3.2	0.3	18.4	5.5	13.2	26.9	12.4	20.1	194	27.3	21.6	51.1
Kwangsi	42	246	3.7	—	22.3	0.8	8.9	31.8	13.4	19.1	168	7.8	24.4	57.8
Total	871	6,145									4,022			
Average			2.4	2.6	8.8	5.5	13.1	24.2	18.4	25.0		19.8	33.9	46.3

Source: The National Research Bureau, *Crop Reporting in China, 1934*, August 1936, p. 70.

Under the customary village law, this mortgage was usually a conditional sale, for the mortgaged land legally belonged to the mortgagee, the mortgagor maintaining a nominal right to redeem it. Interest on mortgages was in the form either of the net income of the land or of fixed rent. Loans on the security of household goods and rural instruments were granted especially by pawnshops, and loans on the security of products were advanced by merchants as well as by pawnshops; banks and co-operative societies made loans on growing crops and agricultural commodities deposited in go-downs. Rates of interest varied greatly in the various districts and according to the particular nature of the lenders and borrowers.

The largest share of agricultural credit was not for productive purposes.

TABLE 24B

RURAL FINANCIAL CONDITIONS IN CHINA IN 1934: ANNUAL RATE OF INTEREST

Province	No. of Hsiens reported	No. of cases of "Interest Rate" reported	Percentage of loans in different interest groups				
			10–20%	20–30%	30–40%	40–50%	Over 50%
Chahar	6	8	12.5	62.5	12.5	..	12.5
Suiyan	11	16	18.7	12.5	6.2	43.9	18.7
Ninghsia	4	7	..	..	28.5	14.2	57.3
Tsinghai	5	21	..	42.9	19.0	14.2	23.9
Kansu	21	36	2.7	22.3	19.4	27.8	27.8
Shensi	42	106	0.9	6.6	29.3	12.2	51.0
Shansi	75	188	2.6	17.0	40.6	27.6	12.2
Hopei	105	469	6.6	46.7	43.8	2.5	0.4
Shantung	83	258	5.4	35.7	37.0	20.0	1.9
Kiangsu	47	167	14.3	48.7	25.2	5.9	5.9
Anhwei	33	81	1.2	32.1	38.3	11.1	17.3
Honan	63	158	1.2	10.8	52.8	19.2	16.0
Hupeh	25	40	7.5	50.0	27.5	7.5	7.5
Szechuan	67	147	15.6	32.7	40.9	6.1	4.7
Yunnan	34	48	8.3	39.6	37.6	4.1	10.4
Kweichow	21	31	..	15.2	65.5	12.9	6.4
Hunan	36	85	1.1	44.9	43.6	4.7	5.7
Kiangsi	27	49	16.3	73.5	10.2	..	..
Chekiang	46	85	41.2	57.7	1.1	..	..
Fukien	29	47	31.9	63.9	4.2	..	..
Kwangtung	49	112	18.8	48.2	30.4	0.9	1.7
Kwangsi	42	100	1.0	34.0	55.0	6.0	4.0
Total	871	2,259					
Average			9.4	36.2	30.3	11.2	12.9

Source: The National Agricultural Research Bureau, *Crop Reporting in China, 1934*, August 1936, p. 71.

TABLE 24C

RURAL FINANCIAL CONDITIONS IN CHINA IN 1934: PERIOD OF LOAN

Province	No. of Hsiens reported	No. of cases of "Loan Period" reported	Period of loans classified (in per cent): Under 6 months	6–12 months	12–24 months	24–36 months	Over 36 months	Indefinite
Chahar	6	8	..	75.0	..	12.5	..	12.5
Suiyan	11	15	26.6	60.2	..	6.6	..	6.6
Ninghsia	4	7	..	71.5	..	..	..	28.5
Tsinghai	5	21	..	71.4	4.8	4.8	9.5	9.5
Kansu	21	36	16.6	47.4	5.5	22.3	2.7	5.5
Shensi	42	100	48.0	42.0	3.0	1.0	1.0	5.0
Shansi	75	188	39.4	51.2	3.1	3.7	..	2.6
Hopei	105	700	10.4	84.6	0.8	1.8	0.4	2.0
Shantung	83	246	18.7	74.1	1.2	2.8	..	3.2
Kiangsu	47	164	6.0	75.8	9.1	1.8	0.6	6.7
Anhwei	33	76	11.8	60.7	9.2	2.6	5.2	10.5
Honan	63	149	17.5	68.6	2.0	4.0	0.6	7.3
Hupeh	25	40	5.0	75.0	2.5	..	..	17.5
Szechuan	67	142	11.2	69.2	4.2	1.4	2.8	11.2
Yunnan	34	47	6.3	51.2	12.7	4.2	2.1	23.5
Kweichow	21	24	12.5	62.6	8.3	4.1	..	12.5
Hunan	36	78	3.8	66.8	1.2	5.1	2.5	20.6
Kiangsi	27	38	7.8	63.4	2.6	5.2	5.2	15.8
Chekiang	46	83	9.8	80.4	3.7	..	1.2	4.9
Fukien	29	42	4.7	59.7	7.1	7.1	2.3	19.1
Kwangtung	49	108	15.7	53.0	4.6	2.7	8.3	15.7
Kwangsi	42	96	7.3	59.4	8.3	16.7	1.0	7.3
Total	871	2,408						
Average			12.6	64.7	4.3	5.0	2.1	11.3

Source: The National Agricultural Research Bureau, *Crop Reporting in China, 1934*, August 1936, p. 72.

TABLE 25

USES OF FARM CREDIT

1933–1935

	In national yuan	*In per cent*
Family expenses (food, clothing, etc.)	27.60	32.1
Special events (weddings, funerals, illnesses, etc.)	17.00	19.7
Emergency expenditures (bandits, lawsuits)	10.90	12.7
Commercial purposes	9.10	10.6
Investments in land and buildings	7.50	8.7
Other productive purposes	7.10	8.2
Others	6.90	8.0
Total	86.10	100.0

Source: Nan Ping-fang, *A Practical Study of Rural Credit in Four Provinces of Central China*, Nanking, 1936.

According to the investigation made in four provinces of central China (Honan, Hupeh, Anhwei and Kiangsi) for the period 1933-35, an average debt of CN$86.10 was distributed as shown in table 25.

This indicates that only 27 per cent of the credit went into productive uses, while 73 per cent went into consumption. Since banks limited their advances to productive uses, they were not in a position to expand operations in rural financing, until less consumption credit and more productive credit could be distributed to farmers. In 1935, the loans of the Bank of China to 126,000 rural households scattered over eighty *Hsien* in nine provinces were divided as follows:[6]

	In per cent
Fertilizers	34
Draft animals	23
Farm implements	18
Seeds	4
Food	4
Irrigation	2
Other	15
Total	100

Co-operative societies under the control of the banks preferred tangible security; the others, including those under the control of the China International Famine Relief Commission, were eager to accept endorsement by one or more guarantors; all, however, extended credit only for productive purposes. Moreover, banking and co-operative credit was usually granted for a seasonal cycle of rural production, and it could not be used for long term rural improvements.

Two major problems prevailed, therefore, in the field of rural financing before the Sino-Japanese war:

(a) Credit for unproductive purposes was predominant;
(b) Credit for productive purposes was limited to the seasonal cycle, and there was evident lack of intermediate- and long-term credit for developmental purposes.

With regard to the first point, the National Government endeavored to reduce, through propaganda and political pressure (e.g., the New Life Movement), such social expenses as weddings, funerals, etc., which placed a heavy burden upon

[6] Chang, F. Y., "Banking and Currency," *The Chinese Yearbook*, 1936-1937, p. 801.

the peasantry. The problem of reducing other emergency expenditures, such as those deriving from banditry and lawsuits, depended mainly upon the success of the political unification of the country and the introduction of modern methods of land survey. Loan requirements for real consumption needs (food, clothing and other family expenses) were caused by the steady deterioration of the rural economy after the end of the First World War. Floods and soil erosion were largely responsible for the widespread famines of China, and the famines in turn resulted in debts. Building of dikes, afforestation and extension of the transportation system were expected eventually to take care of these basic illnesses. These basic causes of consumption debt could not be cured by more credit or by different bank policies. Such other palliatives, as limitations on the rate of interest and exorbitant taxes on pawnshops, usually had the opposite effect of what was desired, since they contributed toward restricting the sphere of legal lending operations and gave rise to a black credit market, thereby actually increasing the burden imposed upon the debt-ridden farmers.

With regard to the second point—credit for productive purposes—it would seem that during the period from 1931 to 1935 particular difficulties were created by the outflow of funds from the rural districts to the coastal cities, causing a stringency in the interior money markets. The inability of the farmers to provide the kind of security required at first prevented the modern banks, which had accumulated considerable idle funds, from coming into contact with the farming sections. The introduction of a collective guarantee, through the assistance of the co-operative societies, was attempted as an experiment which proved successful. In the opinion of the Bank of China, the intervention of banking credit reduced rural interest rates from levels of 30 to 100 per cent to levels of 20 to 30 per cent per annum.[7] However, the banks granted only short-term credit. This could not be invested in permanent rural improvements, such as the introduction of crops requiring mechanized equipment, the transfer of submarginal land to normal productivity and the increase of per capita and per hectare production. Very often, the only improvement, if any, consisted in substituting a richer crop for one less valuable in price. The Charter of the Farmers Bank

[7] Bank of China, *Annual Report,* 1935.

of China provided (Art. 12) for the issue of debentures, with a view toward obtaining funds for fixed loans to agriculture. The lack of a market for these bonds remained a major obstacle, and no funds could be raised by this method. In 1937, the Agricultural Credit Administration, organized by the National Government, started its operations as intermediary guarantor between lending banks and borrowing agricultural co-operatives; this was expected to open the way for a flow of funds from the banks to agriculture for middle- and long-term financing.

The Financing of Trade. The financing of trade was carried on by all types of banking institutions.

With the accumulation of funds in the hands of the foreign banks, ample facilities always existed for foreign trade. In fact, the danger was usually in overtrading positions rather than in a shortage of credit. During the 'twenties, native banks acted as intermediaries between the Chinese merchants and the foreign banks, providing a bank's guarantee through the issue of their cashier's order; only a few modern banks (the Bank of China, the Shanghai Commercial and Savings Bank, the National Commercial Bank and the Chekiang Industrial Bank) transacted foreign trade business, and that was limited. Credit requirements were generally less strict than abroad, and interest and charges were usually higher, in harmony with the money rates predominant in the Chinese market.

This situation underwent some changes during 1936-37, due to the intervention of the National Government in the field of foreign trade, through barter and monopolistic transactions. Financing of trade on official account was entrusted to the Bank of China, which used foreign balances accumulated abroad through the sale of silver. The intervention of the Bank of China in this field resulted in an unusual scarcity of foreign commercial paper in the open market and, as a consequence, keen competition arose among foreign and modern banks dealing in foreign exchange.

Since the domestic trade organization failed to keep pace with the modernization of banking, domestic trade remained the special domain of the native banks until the late 'twenties, and modern banks were compelled to adopt unorthodox methods of financing in order to make their way in this field. By granting loans on the security of goods deposited in go-

downs, modern banks in the course of time were able to attract the financing of wholesale trade transactions. The operations of foreign banks in domestic trade were usually indirect, proceeding through the intermediation of native banks and foreign commercial firms. The function of the native banks was comparable to that of the bill brokers in a western market; namely, to find employment for idle funds of foreign banks. The decline of the native banks compelled foreign banks to rely upon direct contacts with the Chinese market and to enter into competition with modern banks for the financing of wholesale commerce.

The situation in retail trade (shopkeepers and peddlers) was not nearly so satisfactory. With the decline of native banks, this trade was left without adequate financing agencies: these banks were the only type of institution which granted the one sort of credit (unsecured loans) that small merchants could use. The turnover of their goods being most rapid, shopkeepers and peddlers were not in a position to transact business on a scale large enough to interest modern banks, or to immobilize goods for advances from pawnshops. The importance of this minute credit cannot be measured statistically, but is very great.

Measures of various sorts were taken in the middle 'thirties for relieving the acute credit shortage suffered by small trade. Provincial and municipal Governments established public loan offices to take care of small advances to peddlers and shopkeepers. Modern banks either co-operated with official authorities by placing special funds at the disposal of public loan offices, or they set up special accounts of their own for unsecured loans. No general policy, however, was developed out of isolated instances, and the problem remained unsolved.

The Financing of Industrial Activities. Industrial firms in China during this period may be classified into three groups: (a) subsidiaries of companies established abroad; (b) local independent enterprises, owned or controlled by foreigners, and (c) Chinese enterprises. The financing of industrial activities was effected in different ways.

The industrial capital of subsidiaries of foreign companies was supplied from abroad, a local foreign bank usually acting as agent for foreign interests. Local independent enterprises

owned or controlled by foreigners raised their capital within the close circles of the local foreign communities, usually with the backing of a foreign bank, seldom with the active support of a foreign finance company. Neither of these two types of industrial enterprise used to come into direct contact with modern banks. Chinese enterprises lacked the support of an investment market, since the so-called Chinese finance companies failed to develop important functions and modern banks did not take an active industrial initiative. This lack of industrial interest on the part of capital in an undeveloped country finds its justification in two facts: first, the banks' resources were mainly formed by short-term deposits; second, the pursuance of a protective industrial policy by the National Government was bound by restrictions imposed upon China by foreign treaties. The banks took the view that it was the business of the industrialists to get started; they would, however, readily supply operating concerns with working capital, on the basis of solid security, such as that offered by mortgages of the plant and deposit of commodities in go-downs. This, however, proved insufficient to relieve the banks from the risks involved, and the lending institutions were compelled to take over the plants when the loans were not repaid.

In general, Chinese industries were under-capitalized. The capital of the promoting group was large enough to buy the site, but seldom to buy the machinery; it was not unusual for a plant to be owned by one group and operated by another. Renting of the plant was often agreed upon for seasonal cycles of production; in this way the operators were not burdened with expenses for maintaining idle plants in periods of low activity. Supplementary fixed capital was obtained through friends and acquaintances, in the form of cash deposits on which the industrial firm paid interest at a rate lower than that charged on bank loans, but higher than that paid by banks on deposits. Working capital was supplied by native and modern banks on the security of the plant (*tsangchi*) or upon deposit of raw materials and goods in go-downs. As a consequence of this situation, outpayments for capital and credit supply ran into high rates. In the opinion of L. G. Ting and H. D. Fong, who made studies of the financial situation of cotton and flour mills in Tientsin, the industries obtained extra funds equivalent to 100 per cent of their capital in the form of bank loans

and as much as that or more in the form of private deposits at fixed interest, ranging from 6 to 20 per cent.[8] According to a Chinese industrialist, invested capital demanded a new profit of 18 to 20 per cent, a rate which most Chinese industries were unable to pay; as a result, industrial activity was turned into speculative ventures.[9]

In the field of public utilities, a few companies operating in foreign concessions were financed by issues of debentures through foreign banks and a Chinese banking syndicate (headed by the Chekiang Industrial Bank); these debentures were traded in the local stock markets. Financing of Chinese municipal enterprises was done mainly through mortgage loans from Chinese banks, a technique similar to that applied in the case of industrial plants. Financing of the communications system was part of the Government financial operations. Before 1930, railway financing was monopolized by foreign banks; during the 'thirties, however, modern banks assumed the burden of providing funds for expanding communication facilities. The technique which was developed consisted of the banks' making advances to the Ministry of Railways on the security of 6 per cent Government bonds received at a value approximating the expected market price (or at a discount of from 20 to 30 per cent of face value). Moreover, the banks undertook, on similar bases, to guarantee credits opened in favor of the National Government by foreign firms exporting railway materials. In all cases, the eventual settlement was effected by transferring to the banks the ownership of the bonds deposited as security. As of July 1, 1937, the outstanding amount of advances granted to, or guaranteed for, the Ministry of Railways by banks totaled CN$130 million; about CN$100 million in railway bonds had been transferred to banks in previous years. In addition, between 1929 and 1936 modern banks financed about CN$200 million of public works by receiving bonds secured on provincial revenues and guaranteed by the National Government.

Despite the progress made, the status of industrial financing in 1936-37 still was inadequate. However, the accumulation of fixed deposits in modern banks, the promulgation of pro-

[8] Ting, L. C., "Chinese Modern Banks and the Finance of Government and Industry," *Nankai Social and Economic Quarterly,* October 1935, pp. 597-616.

[9] Zai Ziang-zee, "Reconstruction Through Industrialization," *China Quarterly,* December 1935, pp. 143-153.

tective tariffs by the National Government in the early 'thirties and the establishment of the China Development Finance Corporation tended to remove the major obstacles opposing a policy of industrialization by the banks and the development of an investment market.

The Financing of Real Estate and Speculation. As in all economic systems at a pre-capitalistic stage, there was no organized market for real estate credit in the interior of China. On the contrary, real estate credit developed in the Treaty ports, due to the rapid modernization of some municipal centers and the large accumulation of idle funds in search of employment. At its very beginning, therefore, real estate was connected with speculation; actually, it was the most popular form. Foreign real estate and finance companies, as well as savings societies and native banks, played the leading roles in this field. Their funds were raised either by direct mortgage or by the issue of debentures, which found an easy market among foreign residents and Chinese citizens. The exact part played by the banks remained obscure, but it was undoubtedly large in all types of institutions, native, foreign and modern. It was not until the native bank crisis of 1932 that a substantial part of their assets was revealed as consisting of property deeds. Modern banks invested in real estate funds obtained from savings and trust departments and subsidiary savings institutions. Some foreign banks were so tied up with real estate and finance companies that they were forced into bankruptcy when the boom subsided. The speculation was especially directed toward the areas situated in the French Concession and in the International Settlement in Shanghai.

In the years immediately preceding the Sino-Japanese war, however, the real estate business was in a lethargic state. In spite of the marked recovery of business in general and the easy money conditions prevailing during 1936 and 1937, land prices did not show much change as compared with the depression levels, business transactions declined further and foreclosures on defaulted mortgages still ran into millions of national yuan. A clear indication of the conditions of the real estate market may be seen in table 26, on page 214.

In such a depressed situation, debentures and shares of real estate and finance companies continued to be quoted at extremely low levels, if and when transactions were effected.

TABLE 26

REAL ESTATE TURNOVER IN SHANGHAI

1930–1937

(In national yuan)

1930	84,446,100
1931	183,216,700
1932	25,174,900
1933	43,136,200
1934	12,990,150
1935	14,460,400
1936	12,001,350
1937	6,269,350

Source: *Finance and Commerce.*

According to the Shanghai Stock Exchange Official Share Report, during 1935, 1936 and 1937, no business was transacted in the shares of the eleven land companies and of five out of the six finance companies quoted in its list. Payment of dividends remained in abeyance after 1935. Several proposals were made in Shanghai's foreign press for promoting a revival in the real estate market; the project of a central real estate trust or mortgage bank seemed to have awakened the interest of Chinese banking authorities in 1936, but it failed to materialize.

Another common form of speculation was represented by operations in foreign exchange and bullion. This type of speculation was not so popular as the other, but it was so important that it made Shanghai the most speculative exchange market in the world. Transactions were carried on by two groups—foreign banks, operating mainly on foreign exchanges, and the so-called "speculators," operating mainly in "fictitious" gold bars in the Shanghai Gold Stock Exchange (which closed its doors on August 14, 1937). Settlement was usually effected through the "changing over," that is, instead of actual delivery on settlement day, old contracts were renewed by new contracts and profits and losses were settled in cash. The requirements for financing speculation of this type were therefore limited.

Exchange and gold speculation also subsided during the first half of 1937, after some outbursts of operations in the national yuan had been defeated by "bear squeezes" applied by the Central Bank of China and the Bank of China. According to *Finance and Commerce,* at the middle of 1936 speculators in the Shanghai market had an overbought position amounting

to about $17 million; this was liquidated in August. In September and December 1936, speculators again built overbought positions estimated at $9 million and $6 million, respectively. In each case, uncovered operators were obliged to close with losses. During the first half of 1937 speculative operations in the exchange and gold market were rather insignificant.

Speculating in commodities is part of China's mercantile tradition. Native banks showed special interest in this field, either by financing private operators or by participating directly in commodity hoarding. Speculators in commodities were never seriously hampered by lack of funds, since it was always possible to deposit the cornered goods in go-downs and obtain advances from native or modern banks.

In the stock and bond market, Government obligations were a special object of speculative attention. It could not be estimated to what extent banks were directly involved in this field, but it was generally known that the portfolios of native and modern banks contained sizeable amounts of Government bonds. It was suggested that low priced obligations were preferred as a speculative investment, because their net yields were somewhat higher and fluctuations in their prices wider than average. In 1935 the Bank of Communications undertook "to extend loans to arbitrage operators, who wished to take advantage of the difference in the interest rates," with a view "to upholding the credit of the Government, as well as to cooperating with other banks in maintaining market liquidity."[10] This intervention of the Government banks helped to narrow the spread between marginal prices and to bring down the net yield; the Government security market, however, continued to be characterized by speculative activities.

The Financing o fthe Government. During the pre-war decade, the National Government maintained a strict policy of not issuing loans abroad for the purpose of covering budgetary deficits. Between 1928 and 1937 the accumulated deficits of the central administration amounted to CN$1,530 million; this was entirely covered by domestic borrowings. Institutions in a position to participate in public financing through savings accumulation were not developed. The insurance business was monopolized by foreign firms (mostly British), while industrial or commercial companies did not

[10] Bank of Communications, *Annual Report,* 1935.

dispose of available liquid cash reserves. Educational and other non-profit institutions generally had no funds of their own, but lived on grants from abroad. Therefore, there could not be a public market for Government bonds, and the burden of financing Government deficits rested on the banks. The Savings Bank Law of 1935 required savings institutions to deposit with the Central Bank of China public bonds or other reliable securities equivalent in value to at least one fourth of their total savings deposits (Art. 9). This requirement was not extended to other banks. However, since Government bonds were eligible as reserve against currency in circulation, banks were in a position to obtain legal currency by depositing an equivalent amount, of which 60 per cent was in silver or foreign exchange and 40 per cent in Government bonds. Native as well as modern banks made extensive use of this privilege, although it is doubtful whether the rule continued to be legally valid after the currency reform of November 1935.

Considerable obscurity exists with regard to methods employed in credit financing of deficits. The immediate needs of the National Treasury were met by direct advances from banks. All operations connected with long-term Government financing were handed through the National Loan Sinking Fund Committee formed by Shanghai bankers. The Government bonds were delivered to the banks by the Treasury either as security for advances or for other special purposes such as Government contributions to bank capital, compensation for losses suffered by banks in operations of public interest or readjustment of local currencies. In the first case, final settlement was effected by transfer of the ownership of the bonds at market prices; in the second case, bonds were usually transferred to the banks at a very limited discount or at par and often at nominal interest of 2½ per cent—this type of bond could not possibly find a ready market. The extent to which banks were called upon to finance the National Government may be indicated by the following figures: on January 1, 1936, when the internal debt was consolidated, there were twenty-seven bond issues of the National Government outstanding (issued after 1927), with a face value of CN$1,554 million; on June 30, 1935, the amount of accrued annual balances of loans and overdrafts granted by banks to the National Government

totaled CN$390 million; on July 1, 1937, China's outstanding internal bonds amounted to CN$1,819 million, and provincial bonds guaranteed by the National Government amounted to CN$196 million.

During the years from 1927 to 1933 the yield on Government bonds ranged from more than 20 per cent to slightly above 10 per cent. The usual nominal rate was 7 to 8 per cent; therefore, the discount at which the bonds were sold in the market was very high. In the opinion of Chinese writers, the cash receipts of the National Government from bonds with a total face value of CN$1,465 million, issued between 1927 and 1934, amounted to only CN$809 million.[11] This estimate for a period in which the credit of the National Government was at a low ebb and the interest paid very high may be compared with loans issued in 1936, after the internal public debt had been refunded at a flat 6 per cent and the credit rating of the National Government was at its highest. During 1936 modern banks granted loans and advances to the Ministry of Railways amounting to CN$86 million, receiving as collateral Government bonds with a face value of CN$110 million, which bore an interest rate of 6 per cent (yield of 7.6 per cent per annum). Despite this considerable achievement, it was evident that the National Government was still obliged to pay a relatively high cost for its financing operations. The formation of a public market for Government bonds, with a view to attracting capital from the standpoint of permanent investment rather than speculative profit, remained an objective rather than a reality.

Summary. In summarizing this analysis, it may be stated that in 1936-37 the credit standing of the various economic activities differed widely. Large scale trade, both foreign and domestic, and speculative operations never were hampered by lack of funds; small trade, on the other hand, faced a difficult shortage of credit. The system of co-operative societies was intended to provide short and intermediate bank credit to the farming sections of the country. No measures, however, were taken for supplying consumption credit, and the problem of long-term financing of agricultural rehabilitation, industrial development and Government outlays remained unsolved. The

[11] Chu Hsien, "Problems of China's Public Finance," quoted by Ting, L. C., *loc. cit.*, p. 591.

changes in the banking system and credit structure of the country had been more rapid than the transformation of the other economic sectors of the Chinese society.

Two basic problems therefore confronted the Chinese credit institutions in 1936-37: first, how to provide funds for the traditional forms of economic enterprise, and second, how to promote balanced readjustments among the various economic sectors of the country and introduce new kinds of credit instruments. The first was a problem of day-to-day life, the second the problem of the future development of modern China. Other problems, such as the lowering of unusually high interest charges, were only secondary; in fact, their solution depended upon the proper organization and distribution of credit, which could be achieved only through the long run development of the credit institutions. The reform of the central bank as a Government bankers' bank, with a view toward concentrating banking reserves and mobilizing banking funds, was expected to constitute an important milestone in the construction of a modern economic system in China.

THE ART OF CENTRAL BANKING AND PROJECTS OF REFORM

With the reorganization of 1934, the Central Bank of China was designed to assume a position of leadership in the financial market. However, the bank was hampered in its operations by the complex situation arising from the traditional distribution of central banking functions among various institutions. It was only in January 1936 that the central bank obtained the deposit of a share of clearing funds, previously kept entirely with the Bank of China and the Bank of Communications. Centralization of holdings of public funds was never fully accomplished and reserves against note issue and deposits continued to be shared with other institutions. The contacts between the central bank and other banks were made difficult by the lack of adequate instruments. Since the quantity of paper eligible for discount was insignificant and there was no rediscount market, no rate policy could be developed. The securities market was essentially speculative, and orderly distribution of Government bonds (such as that carried on by the Bank of Japan) could not be achieved. No legal reserves were

required for ordinary banks; bankers' balances at the central bank were rather insignificant; and no national clearing system existed. Moreover, the Central Bank of China was hindered by the presence of foreign banks, which, through their resources and operations, commanded a leading position in the market and could not be brought under centralized control.

In November 1935, the National Government decided that the Central Bank of China should be reorganized as a central reserve bank. In his statement issued on November 3, 1935 on the Currency Reform, the Minister of Finance, Dr. H. H. Kung, announced that:

> . . . the Government-owned Central Bank is to be reorganized as the Central Reserve Bank of China and will be owned principally by banks and by the general public, thus becoming an independent institution, devoting itself chiefly to maintaining the stability of the nation's currency. The Central Reserve Bank of China will hold the reserves of the banking system and act as depository of all public funds and will provide centralized rediscount facilities for the other banks. The Central Reserve Bank of China will not undertake general commercial business, and after a period of two years will enjoy the sole right of note issue.

A committee of experts was thereafter charged with submitting a report to the National Government, based on an exhaustive study of proposals suggested by foreign experts. On March 24, 1937, the Draft Law governing the Central Reserve Bank of China was adopted by the Central Political Committee and referred to the Legislative Yuan for consideration and enactment. The Finance, Economic and Commercial Law Committees of the Legislative Yuan examined and passed the Draft Law on June 19, 1937; enactment, however, was delayed and suspended with the opening of the Sino-Japanese war.

The proposed Central Reserve Bank of China was to be chartered for a period of thirty years, with the head office established in the capital (Nanking), branches set up throughout the country and agencies opened in important localities within and without China. Its capital was to be fixed at CN$100 million, distributed into one million shares of CN$100 each; these shares were to be divided into four classes:

400,000 A shares subscribed by the Government	CN$40,000,000
50,000 B shares subscribed by provincial and municipal Governments	5,000,000
350,000 C shares subscribed by Chinese banks	35,000,000
200,000 D shares offered for public subscription	20,000,000

The powers and functions of the institution were described as follows:

(a) To centralize the legal reserves of the various banks, in accordance with the law;
(b) To develop the financial market, improve the credit system and facilitate the utilization of the capital of the various commercial banks;
(c) To issue legal tender notes;
(d) To readjust the national currency and credit, and to provide adequate elasticity in order to stabilize the exchange value of the national yuan;
(e) To serve as the agent of the National Treasury;
(f) To serve as the agent for the issue of Government and foreign loans and repayment of principal and interest thereof, as well as to re-adjust, during the issue of such loans, the relations between the new loans and the market and foreign trade.

It was also provided that the bank should have a board of directors of eleven persons, of whom five were to be appointed by the National Government and three each to be elected from among Class B and Class C shareholders. It was stipulated that shareholders should not be allowed to hold other Government posts at the same time. The governor and deputy-governor were to be elected from among the directors. Control over the bank was to be exercised by a board of supervisors of six persons, of whom four were to be appointed by the National Government and one each elected from among the directors.[12]

In its main lines the Draft Law followed the Project of Law for the Creation of the Central Reserve Bank of China, submitted by the Kemmerer Commission in 1929. The Kemmerer Project made provisions for a Central Reserve Bank with a capital of 50 million Suns (the gold monetary unit proposed by the same Commission in its Project of Law for the Gradual Introduction of the Gold Standard Currency System in China), distributed into shares of 100 Suns each of three types; namely, Class A, held by the National Government, with no voting right; Class B, held by affiliated banks, and Class C, offered for public absorption. Eligible affiliated banks were to be any modern or native banks holding deposits totaling 500,000 Suns or more, and approved by the Superintendent of Banks and the board of directors of the Central Reserve Bank of China. The management of the bank was to be entrusted to a board of nine to twelve directors; three (class A)

[12] *Finance and Commerce*, February 12, 1936; March 31, June 23, 1937.

appointed by the Minister of Finance; three (class B) elected by affiliated banks; one to three (class C) elected by private shareholders; plus three additional directors selected from businessmen, professional men and farmers by the board of directors itself. The board was to be charged with the election of a president, one or more vice presidents and a general manager and with the appointment of the managers of the branches. Bank officers were not to be allowed to maintain other political or outside banking positions.

The operations of the bank were to be distributed into three groups: those in connection with affiliated banks, those in connection with the general public and those in connection with the administration of Government finances. The rates of discount were to be fixed from time to time by the board of directors, differential rates being applied on operations with affiliated banks and the public, on different types of paper, on different maturities of loans and on loans made at the head office or branches. The rates on Government paper or loans were to be equivalent to those charged on affiliated banks for the best class of paper with the same maturity. The restrictions placed upon the bank concerned dealings in real estate, advances to the Government, terms of loans, amount of loans granted to any affiliated bank or other firms, payment of interest on official deposits, purchase or acceptance of commercial paper and government or other public obligations. The Central Reserve Bank of China alone had the right to issue notes based on the gold standard unit, the Sun. Finally, the plan provided for a system of publicity of the operations of the bank, through public statements and annual reports.

The Kemmerer project represented a valuable document on pure central banking theory hardly applicable even to a western country; its actual usefulness to the economic, political and social conditions of China remained open to most serious doubts. Its proposals on discount operations, acceptance of commercial paper and restrictions on the commercial business of the central bank were embodied in the law of the Central Bank of China of 1935; these regulations, however, found no application owing to the lack of adequate credit instruments. The authors of the project for the reorganization of the Central Bank of China into a central reserve bank took more practical views and directed their efforts toward making

the new institution an executive agency connecting the National Government and the money market of the country. It may be suggested that the most important documents in the field of banking issued in China during the last decade were not those proposed by foreign experts, but proved to be those prepared by Chinese financiers under the stimulus of immediate needs—the Regulations Governing the Joint Reserve Board probably being the most significant example. It could have been expected, therefore, that the proposed Central Reserve Bank of China would have pursued the reasonable policy of adapting its operations to China's financial and economic requirements, rather than of attempting to set up an ideal standard of central banking.

CONCLUSION

At the close of the first decade of the Kuomintang regime, the trend of China's modern banking system was directed toward concentration of reserves, mobilization of funds and coordination between the credit market and the agricultural, industrial and public sectors of the national economy. When, in July 1937, China became engaged in a life-and-death struggle, the program of peacetime economic development had to be set aside, and the Government banks assumed the leadership of the economic resistance of the country. Ordinary banks were confronted with a basically critical situation, since they had establishments distributed mainly over occupied China, operating amid a currency war waged between the Government banks and newly established reserve banks of issue under Japanese domination. Moreover, the wartime conditions dictated that immediate steps be taken by modern banks for the following purposes:

(a) To maintain the money market liquidity and avoid panicky runs;
(b) To supply credits in foreign currencies for the Government military purchases abroad and stabilize the exchange rate of the national yuan;
(c) To finance Government deficits on an unprecedented scale;
(d) To promote transportation and industrial development in the western provinces.

Under the impact of the war, old and new currency systems throughout the country developed inflationary trends. Obstacles to intercourse between free and occupied China and restrictions on both sides divided the country into two vir-

tually distinct financial areas. In free China, the modern banks effected the shift from peacetime to wartime operations with comparative ease. The course of the monetary and banking reforms initiated in 1935 was altered in many vital points, while the modernization of agriculture, industry and trade proceeded at an accelerated pace. As a result a more balanced economic and financial structure appeared to be in the offing. In occupied China, despite new financial organs set up under the jurisdiction of Japanese-dominated Chinese authorities, unsettled economic conditions continued to prevail. In examining wartime developments of Chinese banking, the political factor, which is represented by the co-existence of conflicting authorities, demands special consideration.

PART III

Wartime Developments: The Money Markets in China After 1937

CHAPTER IX

THE NATIVE MONEY MARKET

INTRODUCTION

Even in normal times, the statistical and other source material on Chinese banking was scarce and incomplete. Since the outbreak of the Sino-Japanese hostilities very little has been published to show how native and other banking institutions manage their financial affairs. However, by a careful analysis of this information some general trends are discernible.

After ten years, or more, of decline and liquidation, the institutions of the native money market were able to expand their activities anew in the monetary conditions which arose from the military and economic struggle between China and Japan. Currency development throughout the country assumed an inflationary trend. In free China, however, the position of the Government banks was strengthened and the national currency gained in importance and circulation; active opposition from unauthorized currency issues was absent. In the occupied areas, on the contrary, the breakdown of central authority and the disappearance of modern banks deprived entire districts and important financial centers of credit and monetary organs. Even when, usually after long delays and against great obstacles, financial reconstruction was undertaken under Japanese domination, the expansion of notes issued by competitive agencies reintroduced the system of plural currencies, which had been eliminated by the monetary reform of November 3, 1935. General instability of rates prevailed in the domestic exchange and remittance markets throughout the years following 1937. On the whole, the slashing of China into distinct political zones disrupted the process of financial and monetary unification which had been successfully carried on by the National Government between 1935 and 1937. It may be said that, under the impact of the hostilities, China lost her national financial organization, as she did in 1911 when the fall of the Manchu dynasty brought the Shansi banks to an end.

Native institutions were prompt to adjust themselves to the local conditions arising from the war. Their personal ways of dealing, their close ties to the local economy, their independence from modern banks and central authorities and their traditional experience in China's endless turmoils made it possible for them to develop rudimentary forms of money and credit soon after the storm of the battles subsided. Above all, however, native banks recovered the traditional source of their irregular profits —speculation on exchanges, commodities and real estate.

NATIVE INSTITUTIONS IN THE INTERIOR

In Hankow in 1937, about twenty native banks were only carrying on ordinary operations and liquidating overdue accounts. The military campaign of the autumn of 1938 brought all activities of the local money market to a complete standstill. The branches of the modern banks were moved to Chungking and Shanghai prior to the fall of the city (October 1938); although temporary offices were maintained in the French Concession, it is unlikely that they transacted any substantial business. It was not until the latter part of February 1939 that several native banks and cash shops made their appearance again. Their capital was generally small, amounting to CN$20,000 or CN$30,000, and their operations were confined to the purchase and sale of yen (military yen and bank notes) and remittances of limited amounts to Shanghai, Chungking and other ports. The exchange rates between the national yuan, which remained the general medium of circulation, and the yen military and bank notes fluctuated violently, as did the rates for domestic remittances; this provided the exchange shops with a wide margin of speculative profit. The situation in Hankow was probably representative of conditions prevailing in the border zones between free and occupied China.

Prior to the outbreak of war in 1937, Nanking had over forty native banks and cash shops. During the hostilities, many of the institutions had their premises destroyed, and others were withdrawn or closed. For a time, there was not a single financial firm in the former capital. After the inauguration of the Reformed Government of China under Japanese auspices (March 1938) three native banks were formed. More native institutions were established after the new "National" Government was set up by Wang Ching-wei in March 1939; by the end of July 1940

Nanking had a total of eighty native institutions, of which fifty-eight had joined the local native banks' guild. The capital ranged from CN$20,000 to CN$50,000 each. It was reported that in 1940 some of the large native banks made profits of CN$100,000, while the smaller institutions made profits of CN$10,000 to CN$50,000 on exchange speculation.[1]

In Canton, the monetary situation was extremely confused. After the Japanese occupation, in November 1938, native banks remained the only credit institutions in the city. At first, liquidity preference by the public and currency hoarding resulted in an acute shortage of subsidiary currency. Cash shops found an easy source of profit in exchanging one-yuan bills for five- and ten-yuan notes at a heavy premium (sometimes as much as 50 per cent). Later on, the introduction of the military yen by the Japanese Army complicated the situation further. The military yen which was legal tender for purchases of goods and transactions under the control of the Japanese Army, appreciated rapidly in terms of the provincial and national currencies and became the only generally acceptable means of payment, superseding in this function the Hongkong dollar. Local native bankers and money changers set up a "money exchange" in the early part of 1941 to facilitate domestic exchange operations.[2]

The war failed to bring about any basic change among native institutions situated in those zones where a central political authority and a modern banking system were maintained. In all important centers of northern China the decadence of the local native money markets apparently continued uninterruptedly. Native banks in free China attracted funds from modern banks, private organizations and wealthy individuals, who were unable or unwilling to enter directly into speculative activities. As native banks engaged largely in commercial and commodity transactions of a speculative character, they were in a position to borrow on short term and to pay annual interest on current deposits at the native call rate, which averaged between 11.5 per cent in 1938 and 33.6 per cent in 1941 and 1942; this rate was considerably higher than those offered by modern banks.[3] More native banks were established by private individuals as well as

[1] *China News and Views Digest,* August 8, 1941.

[2] *The Central Bank of China Bulletin,* Spring 1940, pp. 79-80.

[3] Stein, Guenther, "China's Inflation Menace," *Far Eastern Survey,* June 1, 1942.

by ordinary modern banks. The number of native banks in Chungking in the spring of 1942 totaled 53, with an aggregate capital of CN$60 million; however, they failed to increase their importance in the money market, in which the four Government banks were occupying an increasingly dominant position.

THE NATIVE MONEY MARKET AND SPECULATION AT SHANGHAI

The international position of Shanghai provided an especially favorable ground for speculation, and native banks readily took advantage of speculative opportunities. In the spring of 1937, the city had a total of forty-six *Wei-wah* (clearing) native banks. At the outbreak of hostilities (August 13) the Ministry of Finance ordered all banking institutions—native and modern—to close their doors for a few days, during which the Emergency Banking Regulations were promulgated. These were applied to native as well as modern banks and strictly limited the amount of cash withdrawals, allowing, however, inter-bank transfer of blocked accounts (*Wei-wah*). Only three native banks went into voluntary liquidation, and on the Lunar new year of 1938 Shanghai had forty-three *Wei-wah* banks in operation.[4]

By the early spring of 1938 the flight of funds from the interior brought to the international zone of Shanghai a plethora of money in search of liquidity and profit, which was characterized by a "special disinclination to permanent investment and a preference for short term speculation of the wildest sort."[5] In June 1939 the Ministry of Finance of the National Government issued further restrictions upon the cash withdrawal of deposits with a view to checking this trend, especially in the field of foreign exchange. As these restrictions resulted in a certain strain in the Shanghai money market, the Joint Reserve Board of the Native Banks Clearing Association agreed to co-operate with the Joint Reserve Board of the Shanghai Bankers Association in making liquid funds available to banks on the security of slow assets. Speculation continued unabated during the rest of 1939 and most of 1940, however, and new funds were readily absorbed into the various channels.

Various authorities offered educated guesses as to Shanghai's accumulation of floating funds although this is impossible to

[4] *The Central Bank of China Bulletin,* Autumn 1941, p. 397.
[5] *Ibid.,* Autumn 1940, p. 338.

estimate in precise terms. Shanghai's *Banking Weekly* stated on May 28, 1940 that the amount in the form of current accounts with banks and privately stored cash totaled about CN$2 billion; American authorities estimated that in the summer-autumn of 1940 there was more than CN$3 billion of idle money in the city.[6] During the months from July to October 1940 the influx of capital assumed unprecedented proportions, some CN$500 million being transferred from Hongkong, and the utilization of unemployed funds began to encounter increasing difficulties.[7] Channels into which funds could be directed became more limited; in fact, in the latter part of 1940 and in 1941, there was evidence of lack of activity in various speculative markets as a result of unstable world conditions.

Although their resources compared unfavorably with those of foreign or modern institutions, the Shanghai native banks—in shifting their attention and funds to the various fields according to opportunities in exchange and gold, stocks and bonds, commodities and real estate—usually initiated the speculative movements of the local market.

Speculation in foreign exchange and gold was due mainly to the uninterrupted depreciation of the national yuan, which fell from $0.295 in the spring of 1938 to $0.055 in the summer of 1940; thereafter it remained relatively stable. Foreign exchange transactions in the Shanghai market between 1938 and 1940 expanded about five or ten times as compared with pre-war (1937) levels; daily transactions amounted to about $500,000, but rose to as much as $10 million during periods of wide fluctuations. The maximum overbought position was estimated at $15 million, and the maximum oversold position at $7 million; roughly 80 per cent of the transactions were of a speculative character. Gold bars rose from a pre-war value of CN$1,140 to CN$5,500 in the summer of 1940 and exceeded CN$8,000 late in 1941. Prior to November 1940 gold transactions were made privately through gold *hongs* and goldsmiths, but on October 25, 1940, the Shanghai Gold Exchange, Ltd. (registered with the Japanese-dominated "National" Government at Nanking) began its operations; eight native banks joined the exchange as brokers. The daily turnover in the ex-

[6] Barnett, R. W., *Economic Shanghai: Hostage to Politics,* New York, 1941, pp. 127-8.

[7] *The Chinese Economic and Statistical Review,* October 1940, p. 239.

change and curb markets at the middle of 1941 was believed to total some 50,000 gold bars (or $17.2 million) a day. It would be a mistake, however, to regard the tremendous volume of business done as involving huge amounts of capital. In fact, transactions were almost entirely "fictitious" and no actual delivery of foreign exchange and bars was required, margins were very small, and cash settlements were restricted to net profits and losses; financing needs for this type of speculation were limited.

The monetary factors, which favored the revival of native banks in the interior, were also present in Shanghai. Although the national yuan continued to be the generally accepted standard of value and means of payment, the yen (in the form of bank notes and military notes) gained circulation in both the city and some outlying districts and was used for an ever-expanding amount of commercial transactions under Japanese control and for certain official payments. In addition, the notes of the Central Reserve Bank of China were introduced in the market in 1941. Native banks in general, and exchange and cash shops in particular, could therefore claim to be performing an important economic function, by providing a market where the various currencies in local circulation were made readily exchangeable. However, as the yen notes showed a strong tendency to appreciate in terms of national yuan, this market became highly speculative and native banks reaped considerable profits.

Although official trading in Government bonds had been suspended in August 1937, transactions continued on the curb market. The monthly turnover rose from CN$2 million in 1937 to CN$15 million and more in 1938, the average quotation being around 40 per cent of nominal value (as compared with 89 per cent in June 1937). The Government bond market was extremely sensitive not only to political and financial factors, but also to developments in other speculative fields. After 1939, surplus funds formerly utilized by exchange operators were transferred to the bond market, which assumed a firmer tone; quotations of Government bonds advanced to 68-78 by the summer of 1941. Under the impact of inflation in late 1939, foreign stocks also began to attract speculative attention. During a period of hectic activity, in late April and mid-May 1940, foreign textile and rubber shares skyrocketed, with increases of 200 to 400 per cent as compared with opening prices of the year.

Although this boom subsided, with severe losses to bull speculators, the index of the Shanghai Stock Exchange maintained a firm tone and rose progressively after October 1940—the monthly turnover being close to 10 million shares, compared to 3 million in 1939 and about 1.5 million in 1937. Dealing in Chinese stocks—traditionally insignificant—also gained considerable attention from speculators; most shares were traded above par on the curb market.

Speculative dealings in commodities gained progressively in importance as exchange trading declined after the outbreak of the European war in 1939. Holdings of imported commodities (cotton and cotton yarn, rice, wheat flour) were favored over currency, and their prices followed an uninterrupted uptrend after September 1939. In 1941 it was estimated that cotton yarn hoarding amounted to about 400,000 bales and that dealings averaged some 15,000 bales per day, although total yarn production by all Shanghai mills was only 60,000 bales a month. Speculation in exportable commodities (silk), on the contrary, was hampered by restrictions imposed by Japanese authorities and a shortage of shipping space.

The annual turnover of the Shanghai real estate business, which averaged CN$12 million to CN$14 million in pre-war years, rose abruptly to CN$55 million in 1939 and greatly exceeded the CN$100 million mark in 1940. The uninterrupted rise in land values and increased rents brought about a recovery in stocks and bonds of real estate investment companies.

Although no specific and reliable information is available, it is believed that the main business of the Shanghai native banks after 1937 was represented by their participation in the various speculative fields. In fact, the trend of the native interest rate would indicate that conditions in the native money market between 1937 and 1941 followed closely the ups and downs of speculative activity. Despite the abundance of liquid funds available in the market, the native interest rate remained under considerable strain until September 1940, when speculative activity began to lag.

Native banks reaped considerably larger profits from speculation (particularly in exchange and gold, Government bonds and commodities) than from ordinary banking operations. According to *The Central Bank of China Bulletin* (Autumn 1941), the profits of a Shanghai native bank for 1939 amounted to over

TABLE 27

MONTHLY AVERAGE OF THE DAILY NATIVE INTEREST RATE IN SHANGHAI

1937–1941

(in per mille)

	1937	*1938*	*1939*	*1940*	*1941*
January	.08	.10	.12	.13	.06
February	.08	.10	.10	.12	.07
March	.09	.10	.10	.17	.07
April	.12	.10	.10	.20	.07
May	.13	.10	.10	.25	.07
June	.10	.10	.18	.25	.04
July	.10	.10	.18	.20	.04
August	.16	.10	.18	.15	..
September	.20	.10	.20	.12	..
October	.15	.12	.18	.10	..
November	.15	.12	.15	.07	..
December	.12	.12	.15	.07	..

Source: *The Chinese Economic and Statistical Review.*

CN$1 million—unprecedented earnings in the history of native banks—while the other *Wei-wah* banks made profits of CN$100,000 to CN$300,000.

Under the impulse of these factors, the development of the native money market in Shanghai between 1938 and 1941 was characterized, on the one hand, by a mushroom growth of reckless enterprises, and, on the other, by the uninterrupted decline of old established institutions. These trends are indicated by the following table of *Wei-wah* and other officially registered native banking firms:

TABLE 28

DECLINE OF WEI-WAH BANKS

1938–1941

Year	*No. of Wei-wah banks*	*Average capital of Wei-wah banks* (in national yuan)	*No. of other native banking institutions*
1938	43	413,000	28
1939	41	413,000	65
1940	39	408,000	106
1941	39	390,000	137

Source: *The Central Bank of China Bulletin*, Autumn 1941, p. 398.

In addition to these banks, about seventy or eighty exchange and cash shops were operating in the foreign areas of Shanghai without official approval; they transacted banking and other business (including hoarding of commodities), in violation of

banking regulations. In April 1941, the Ministry of Finance of the National Government at Chungking issued an order, addressed to the Shanghai Native Banks Clearing Association, banning all financial institutions not registered with that body, but this order had very little effect on the market.[8]

The growth of wildcat native banks and cash shops explains in part the persistence of the declining trend in inter-bank native clearings evident after 1932 as compared with total (native and modern) clearings, despite the expansion of the number of native institutions in the market.

TABLE 29

MONTHLY AVERAGE OF NATIVE BANK CLEARINGS IN SHANGHAI

1937-1940

Year	Amount (in thousands of national yuan)	*Ratio of native bank clearings to total Shanghai bank clearings*
1937.....	1,402	73
1938.....	817	82
1939.....	427	51
1940.....	281	23

Source: *The Central Bank of China Bulletin.*

As most of the new enterprises failed to become members of the Native Banks Clearing Association, they were not permitted the use of its facilities; therefore, they ordinarily settled their balances in cash outside of the Association. However, this would not explain the fall in the absolute amount of clearings, in view of the apparent expansion of native bank business and the sharp rise in general prices.

Probably the most plausible explanation is that the native banks expanded their cash transactions settled over the counter, but continued to lose documentary credit transactions settled through clearing. In fact, the first group includes such transactions as purchase and sale of currencies, gold, Government bonds, rice and other commodities, in which banks dealt directly with their customers; the native institutions reaped most of their profits from this kind of business. On the other hand, in transactions on documentary credit (performed mainly through the issue of native money orders), the native banks acted as intermediary agents in the financing of domestic trade;

[8] *The China Economic and Statistical Review,* April 1941, p. 90; *Finance and Commerce,* April 9 and June 18, 1941.

despite the high interest rates, these ordinary banking operations had become relatively less remunerative, as compared with direct speculative activities. Moreover, in the Shanghai market, where active competition from modern banks continued to exist, progressively less credit remained to be supplied by native banks to satisfy business requirements.

STRUCTURAL CHANGES IN THE NATIVE MONEY MARKET

In conclusion, it may be said that everything pointed to a rising boom of native banking amidst the political and financial misfortunes of the country. In the Shanghai market the ordinary business handled by native banks continued to contract in both absolute figures and percentage of the business handled by modern banks and the underlying structural deterioration of the native money market was particularly evident. This may be expected to lead eventually to more liquidations and bankruptcies among native institutions, when and if the monetary conditions of the country should become stabilized.

Since 1937 few changes of any significance have been reported in the internal organization of the native money market. Some of the more recently established native banks in Shanghai introduced a "limited liability" capital and a so-called modern organization. It is doubtful whether the modernization of the native institutions went further than altering the external conduct of business; however, the demarcation between newly established large native banks and some of the small modern banks has probably become less evident. It would also appear that newly established native banks were generally capitalized at a higher level than those already in existence, but the steady depreciation of the purchasing power and exchange value of the national yuan made this development altogether insignificant.

More important changes were dictated in the clearing system of the native banks by the critical situation in the Shanghai money market during August 1937. The military hostilities greatly inconvenienced native banks in sending to the other institutions the daily "clearing certificate," which indicated the amount of debit or credit obligations to be settled. The Native Banks Clearing Association, therefore, abolished this practice in favor of a collection of all "clearing certificates" on its premises.

Moreover, while formerly there were two classes of "clearing certificates" (Class A for amounts exceeding CN$500 and Class B for amounts below that figure), a uniform certificate was introduced, irrespective of the amount. Finally, while the clearings of items among native banks were previously made only with respect to checks issued by the native bank members of the Clearing Association, after January 16, 1939, the clearing of checks and drafts circulating among foreign banks was introduced. The new clearing procedure of the native banks was similar to that in force in the Clearing House of the Shanghai Bankers Association, and it represented a simplified and more comprehensive form, as compared with that in existence before 1937.

The procedure for settlements between native and modern banks was also simplified by the Joint Reserve Board of the Native Banks Clearing Association, which became a formally affiliated member of the Shanghai Clearing House on July 4, 1939. Thereafter, native banks sent all items drawn on modern banks to the Joint Reserve Board of the Native Banks Clearing Association, which transmitted them to the Joint Reserve Board of the Shanghai Bankers Association for clearance in the Shanghai Clearing House. By this arrangement, the Joint Reserve Board of the Shanghai Bankers Association became the sole agency through which a unified system of clearing between native and modern banks was made possible.

Thus, the trend which developed in the native money market before 1937 remained basically unaltered during the war. The prosperity which native institutions enjoyed during recent years was chiefly the result of speculative transactions on commodities and domestic and foreign exchanges made possible by the inflationary conditions. Ordinary credit operations of the native banks continued to fall off, both in absolute amounts and as a percentage of the outstanding loans granted by modern as well as native banks. Native banks, however, failed to develop functions and operations counteracting, in the long run, their loss of ordinary banking. It seems doubtful that the native banks can and will survive the present monetary anarchy and eventually adjust themselves to a stable and unified monetary system.

CHAPTER X

THE FOREIGN MONEY MARKET

INTRODUCTION

The development of the foreign money market since 1937 has been influenced by political, military and economic factors, as well as by local, national and international conditions. There is no evidence of any definite and uniform trend, but three stages of transformation may be discerned.

(a) The first stage was marked by bitter fighting in Shanghai and the hinterland (August 1937-October 1938), which resulted in the suspension of industrial production and foreign trade and in the flight of capital from Shanghai to Hongkong and southeastern Asia.

(b) The second stage covered the period from the fall of Hankow and Canton (October 1938) to the economic isolation of Japan and occupied China (summer of 1941). During this stage, Japan launched an economic offensive against free China, by gaining control of the natural resources and exports of occupied areas, tightening the sea and land blockade and pursuing a policy of co-ordination of the Chinese productive capacity to the Japanese economy, at the same time that the yen monetary system was extended to northern China.

(c) The German-Russian war and the American-British-Dutch freezing of Japanese funds (June-July 1941) had the effect of isolating the Japanese economy and the yen bloc from Europe and the sterling and dollar blocs. Before the outbreak of hostilities in the Pacific (December 7, 1941), the freezing measures proved to be effective weapons of economic warfare.

Foreign financial institutions were variously affected, depending upon their national standing and their interests in China.

CESSATION OF BUSINESS ACTIVITY: AUGUST 1937—OCTOBER 1938

On Friday, August 13, 1937, when Sino-Japanese hostilities broke out in Shanghai, all Chinese banks closed their doors;

although foreign banks remained open, naturally very little exchange business was done. On Saturday morning, the Bank of China being closed, the Hongkong and Shanghai Banking Corporation provided facilities for collection and payment of checks and drafts issued by foreign and Chinese exchange banks (members of the so-called Bund group); the clearing of accounts of these banks remained a function of the Hongkong and Shanghai Banking Corporation even after the end of the local emergency. On the following Monday, August 16, foreign banks moved from the Bund, Shanghai's financial district, to temporary quarters, opening offices in the residences of their managers and accommodating their customers with cash for immediate needs.

The market soon suffered a dearth of currency: the Hongkong and Shanghai Banking Corporation and the Nederlandsche Handel-Maatschappij decided to issue their own notes; some of the other foreign banks, including the National City Bank of New York, were prepared to follow suit, if necessary. For a time foreign banks could only meet checks drawn by their own clients, as the usual inter-bank clearances had been suspended. Business on forward exchange also remained at a standstill, as the Central Bank of China refused to provide cover on forward contracts; the foreign banks were forced to carry on or to undertake the liquidation of oversold foreign exchange positions by their own means.

The condition of the foreign money market was further affected by a "gentlemen's agreement," under which foreign banks agreed, in deference to the wishes of the Chinese authorities, not to accept any new deposits from Chinese clients. Furthermore, since accounts in all Chinese banks had been blocked and the transfer instrument, the *Wei-wah* check (not convertible into cash), did not cover settlements between parties outside the modern and native banks and could not be used for the purchase of exchange, foreign banks were not in a position to collect the credits due from Chinese banks, although they were required to make payment on their obligations due to Chinese customers.

It is evident that foreign banks could not have been expected indefinitely to maintain this one-way traffic, in which they were called upon to deliver foreign exchange, to grant commercial credit and to meet withdrawals from deposit accounts, without the opportunity of making simultaneous purchases of foreign

exchange from the Central Bank of China and receiving domestic cash inpayments from Chinese banks and depositors. As a consequence, adjustments were made with a view to restoring business operations of the foreign banks. The establishment of an open market for *Wei-wah* in relation to legal tender national yuan made it possible to cash, at a discount, the assets blocked in Chinese banks, and the "gentlemen's agreement" was eventually permitted to lapse; this again opened the flow of cash into the foreign banks' coffers. On the other hand, beginning October 1, 1937, the Central Bank of China undertook the granting of cover on foreign exchange contracts for merchants' requirements only—a step which permitted the foreign banks to resume forward exchange trading. Conditions approaching normalcy were restored in the foreign money market in October 1937, although the business activity of foreign banks continued to lag for many months afterward.

EXPANSION OF JAPANESE FINANCIAL DOMINATION: NOVEMBER 1938—JULY 1941

From 1938 to the middle of 1941, the condition of foreign financial institutions resembled in many ways that of the native institutions. As in the case of the native money market, the development of the foreign money market was of a local rather than national nature, and it varied according to political conditions rather than economic trends. Specifically, it may be said that Japanese banks found political events favorable to an expansion of their activities. Other foreign banks, on the contrary, were forced to a standstill in Hankow, Canton and southern ports; they were subjected to severe restrictions in Tientsin, Peiping and other northern centers and could prosper only in Shanghai, owing to the aegis of international control. Moreover, as in the case of the native banks, credit operations contracted and foreign banks found their only important source of earnings in exchange transactions mainly, if not exclusively, of a speculative character.

The position of the Hongkong market calls for special attention, as the principle that "Hongkong is economically a part of China" continued to be the basis of the colonial Government's financial policy. The monetary autonomy of the island was reaffirmed in December 1939, with the official British classification of Hongkong as outside the sterling area.

British Banks. The extent to which British banks were affected by the Sino-Japanese hostilities and the monetary restrictions of the sterling area may be indicated by the following figures of the Hongkong and Shanghai Banking Corporation:[1]

TABLE 30

FINANCIAL POSITION OF THE HONGKONG AND SHANGHAI BANKING CORPORATION

(in thousands of Hongkong dollars)

	1936	*1937*	*1938*	*1939*	*1940*
Assets					
Cash and bullion on hand	55,487	87,321	129,461	110,056	142,014
Hongkong Government certificates	141,487	170,610	181,052	165,889	170,789
British, Indian, colonial and other securities	301,420	324,334	354,118	324,918	294,089
Bills discounted, loans and credits	493,813	467,315	454,001	452,274	416,788
Other assets	137,960	182,745	135,209	172,325	222,329
Liabilities					
Capital	20,000	20,000	20,000	20,000	20,000
Sterling reserve	104,874	104,874	104,874	104,874	104,874
Hongkong currency reserve	10,000	10,000	10,000	10,000	10,000
Notes in circulation	127,636	200,254	210,579	195,499	200,491
Current accounts	649,329	700,263	724,134	691,031	764,393
Fixed deposits	188,615	159,897	148,138	148,765	116,528
Other liabilities	18,128	24,909	23,971	45,128	18,846
Profit and loss account	12,085	12,128	12,145	10,165	10,877
Total Assets/Liabilities	1,130,667	1,232,325	1,253,841	1,225,462	1,246,009

Source: Annual Reports of the Hongkong and Shanghai Banking Corporation.

Several facts are evident from the table. Total funds in the hands of the bank remained relatively stable, falling sharply in 1939, but rising again in 1940. However, the customers of the bank expressed their preference for liquidity by shifting their banking assets for fixed deposits to current accounts; in turn, this obliged the bank to increase its cash funds on hand. The steady contraction in the remunerative commercial credit was not compensated by the slight expansion in low interest certificates and securities of the Government. As a result, bank earnings declined and the piling-up of reserves ceased. The condition of the Hongkong and Shanghai Banking Corporation may be considered sufficiently representative of other British banks in China.[2]

[1] In addition to the Hongkong and Shanghai Banking Corporation, the following British banks were operating in China in 1940: Chartered Bank of India, Australia and China, Mercantile Bank of India, Ltd., E.D. Sassoon Banking Co., Moscow Narodny Bank and Thos. Cook and Son (Bankers), Ltd.

[2] On February 1, 1939, the Chartered Bank of India, Australia and China took over the assets and liabilities of its subsidiary, the P. and O. Banking Corporation.

Since the attention of China's monetary authorities was directed toward stabilizing the national yuan in terms of the pound sterling, rather than the dollar, British banks were called upon to play an important role in foreign exchange management for official account. Reference is made specifically to the British loan of March 1939. This loan was granted in the form of a contribution of £5 million by the Hongkong and Shanghai Banking Corporation and the Chartered Bank of India, Australia and China, toward the establishment of a Stabilization Fund for the national yuan; an equal sum was subscribed jointly by the Bank of China and the Bank of Communications. The British Government fully guaranteed the repayment of the contribution made by the two British banks and the payment of interest by the National Government. It was also provided that available sums of the Fund were to be invested in sterling Government securities and commercial paper in London; that the earnings from these investments were to be used to cover the expenses of the Fund, including payment of the interest on the British contributions; and that the national yuan purchased with pounds belonging to the Fund were to be held in national legal tender (bank notes of the four Government banks) in Shanghai or Hongkong for the account of the Fund. The arrangements were scheduled to last for a year, subject thereafter to six-month renewals. The management of the Fund was vested in a committee of five; i.e., one representative from each participating bank and one expert appointed by the National Government in agreement with the British Treasury and with the approval of the British banks. The duty of the committee was to determine the day-to-day policy best suited to achieve the purpose of checking undue fluctuations in the sterling value of the national yuan and to give instructions to the Hongkong and Shanghai Banking Corporation and the Chartered Bank of India, Australia and China, which were entrusted with the market operations of the Fund.

The transactions of the Chinese-British Stabilization Fund have been clothed in almost complete secrecy. As the national yuan was under constant pressure from the flight of capital into foreign currencies, a policy directed to stabilizing the exchange rate in the open market necessitated an almost uninterrupted release of sterling from the Fund. At the time the two banks initiated operations on behalf of the Fund, the national yuan was quoted at 8d. After supporting the national yuan at this

level for three months, the Fund decided at the beginning of June 1939 to allow the national yuan exchange to find its natural level. The rate dropped to 3.250d. by August 1939, but was subsequently stabilized for some months (until April 1940) at around 4d., with adjustments on the dollar according to the New York-London cross rate. It is estimated that the operating banks released at least £5 million between April and June 1939 and repurchased £1.5 million between August and October 1939. Support of the national yuan in the following months again required the release of considerable amounts of sterling, and in May 1940 the British Treasury announced that the Fund was forced to withdraw support from the national yuan and allow it to seek a new low level, because the resources were no longer sufficiently large to maintain the current position. The national yuan rate, left to its own devices, drifted downward until September 1940, when it again settled at around 3.750d. It is believed that £1.6 million was recovered by the Fund as of June 1940 and that a few million pounds more were accumulated by April 1941. Between the autumn of 1940 and the spring of 1941, the Shanghai exchange market was virtually self-supporting, due to the repatriation of funds from parts of the sterling area (Hongkong and southeastern Asia). These operations for official account were accompanied by an intense dealing in pounds by private interests, as sterling accounts of Chinese residents were left free from the restrictions imposed by England and could be freely transferred in the open market. A lively yuan-pound exchange market was provided by the flight of capital from the national yuan to the Hongkong dollar and the pound sterling between the summer of 1937 and the summer of 1939, and by the flight of capital from the sterling area and Hongkong to Shanghai from the autumn of 1939 to the summer of 1941. The British banks, therefore, were in a position to reap substantial profits from exchange operations on both official and private accounts.

American Banks. As the flow of funds after 1938 was directed toward the dollar, rather than toward the pound sterling, American banks accumulated deposit liabilities on a scale probably larger than any other banks.[3] There is no way of estimating pre-

[3] The following American banks were operating in China in 1940: National City Bank of New York, The Chase Bank, Underwriters Bank for the Far East and American Express Company, Inc.

cisely the total amount of capital which took flight to American banks in China, but it is believed that it ran into a few hundred million dollars. According to *Finance and Commerce* of February 12, 1941:

> "It is thought that private capital which has taken flight to the United States may total between $200 and $300 million. Comparatively speaking, Chinese money deposited in London is small. Chinese money in Hongkong is estimated to total about Hk$600 million. Shanghai deposits with foreign banks (mainly in foreign currencies) are calculated at around CN$1,300 million. These figures, although coming from responsible quarters, must be largely natural guesswork."

Although no figures are available, it is generally believed that this accumulation of private funds in American banks was mainly in the form of savings accounts, although large speculative funds were attracted by the relatively higher liquidity of current accounts; fixed deposits, on the other hand, failed to expand correspondingly. American banks became not only the largest safekeepers of Chinese capital, but also the principal agencies for exchange speculation by others. However, as lending opportunities were restricted, the banks were faced with a growing amount of liquid reserves which could not be profitably employed locally. Moreover, as deposits were made in national yuan, but accounts were kept in dollars, the American banks had dollar liabilities which necessitated adequate exchange cover. As a consequence, American banks in China remitted their funds to the head offices and maintained banking balances in New York as cover for their dollar liabilities in the Chinese market. These transactions entailed a large amount of clerical work for the banks, while funds held in New York could hardly be invested at a profitable return. In addition, any restriction (such as "freezing") applied by the United States Government against the movement of funds to and from China would have made it difficult for American banks to settle their dollar liabilities in the Chinese market.

Under the pressure of these circumstances, on March 1, 1941 the American banks in Shanghai announced that (a) local current accounts in dollars (credit balances being available against drawing by check) would be closed immediately and (b) savings accounts in dollars would, beginning April 1, 1941, be subject to a minimum service charge of ½ per cent per month. Parties unwilling to accept current accounts in national yuan or to pay

the service charges on savings accounts in dollars were offered the option of transferring their funds to other foreign or Chinese banks maintaining more favorable terms or of obtaining and holding bank drafts on New York. These measures resulted in a general transfer of funds from the Shanghai branches to the New York offices of American banks, thus helping to alleviate their earning position and to ease the difficulties caused by the American freezing of Chinese assets a few months later. In other parts of China, lack of adequate business opportunities forced American banks to withdraw. The National City Bank of New York closed its branches at Hankow on December 12, 1940 and at Canton on August 31, 1941, while deposit and credit operations at its branch in Peiping were suspended on August 7, 1941.

Japanese Financial Measures. Japan's political domination favored an expansion of Japanese financial interests in occupied China.[4] Upon assuming control of Treaty ports, Japanese military authorities took two important steps; namely, the issue of military yen notes and the seizure of Chinese customs revenues. The issue of currency was a privilege traditionally exercised in China by foreign banks, although it had not been used during the years immediately preceding the Sino-Japanese hostilities. Military yen notes were printed and issued by the Bank of Japan, and the Yokohama Specie Bank, acting as its agent in China, disbursed them. According to Japanese sources, the closest co-operation was established among the Ministry of Finance, the Army's Exchequer and the Bank of Japan. The note policy of the authorities was said to be one of restriction and immediate redemption.[5]

The military yen note should not be confused with a foreign bank note, since it lacked the guarantee of a responsible financial institution and the coverage of a bullion and/or foreign exchange reserve. At first its circulation was enforced by military means, but later on it became general through voluntary acceptance by the public. The military yen notes were originally put into circulation in payment for goods and services and redeemed through fiscal levies and sales of goods and services

[4] The following Japanese banks were operating in China in 1940: Yokohama Specie Bank, Bank of Chosen, Bank of Taiwan, Sumitomo Bank, Mitsui Bank, Mitsubishi Bank, Shanghai Bank, Hankow Bank, Bank of Tientsin and Bank of Tsinan.

[5] *Finance and Commerce,* September 24, 1941.

by the army of occupation. The amount in circulation was officially reported to have totaled 67.9 million military yen in January 1940 and 100.3 million military yen in June 1940. Later developments were clothed in considerable secrecy.

In the summer of 1940 Japanese authorities in China adopted a deflationary course and prohibited the extension of new credits and loans in military yen, while continuing to collect those previously made. This initiated an upward trend in the exchange rate of the military note against the national yuan. The trend was supported by administrative and other measures intended to give the note a "legal tender" status. These measures included compulsory payment in military yen of all imports from and exports to Japanese areas, of railway fares, and of official fees, and free acceptance of military yen by Japanese business and credit establishments. Moreover, the relatively greater stability in the purchasing power of the military yen, as compared with that of the national yuan, stimulated hoarding of military notes by rich Chinese, particularly in Shanghai. Under pressure from these forces, the military yen, which was quoted several points below the national yuan in 1939, advanced to a rate of CN$2.30-2.50 for 1 military yen in the spring of 1941.

At this point, the Japanese Army's Adjustment Fund (a monetary stabilizing fund set up in Shanghai in August 1939) "resolved to use sufficient financial resources to stabilize the value" of the military yen in terms of national currency.[6] The amount of notes in circulation in 1941 was variously estimated, from a minimum of 120 million military yen in central China to a maximum of 600 million military yen in all parts of central and southern China, with 500 millions of this total allocated to central China alone.[7] This currency represented not only an active threat to the circulation of the national yuan, but also a serious obstacle to the introduction into the market of notes issued by the Japanese-dominated Central Reserve Bank of China at Nanking.

The management of the military yen having been assumed by the Yokohama Specie Bank, the Japanese authorities also granted it the custody of customs funds, which had previously been kept by the Central Bank of China. With the exception

[6] *Foreign Commerce Weekly*, April 5, 1941.
[7] *Finance and Commerce*, September 24, 1941.

of CN$25 million (Shanghai customs revenue for the period from January 1 to April 30, 1938) entrusted to the Hongkong and Shanghai Banking Corporation, all customs revenues—collected at Tientsin after October 1937, at Shanghai after May 1938 and at other Treaty ports (Chefoo, Tsingtao, Amoy, Foochow, Hankow, Canton, etc.) after their occupation—were deposited at the various branches of the Yokohama Specie Bank.

This state of affairs was given formal recognition in the accord between Great Britain and Japan of May 3, 1938, by which the British Government agreed that, as a temporary measure during the period of hostilities, "all revenues collected by the Customs at each port under Japanese occupation are to be deposited with the Yokohama Specie Bank. From the revenues thus deposited, foreign loan quotas will be remitted to the Inspector General of Customs to meet in full the servicing of foreign loans and indemnities secured on the Customs revenue." The Governments of the United States and France decided to raise no objection "to the temporary application of these arrangements."[8] Further negotiations, particularly concerning the payment of the Japanese portion of the Boxer Indemnity, were never completed, and the Yokohama Specie Bank failed to remit the loan quotas covering the servicing of China's foreign loans. However, the bank transferred a share of the receipts to the Japanese-dominated "National" Government of China at Nanking and earmarked the balance in a "blocked account" (estimated to amount to about CN$900 million at the middle of 1941).

These monetary and fiscal functions were implemented by powers of supervision and control over foreign exchange transactions. The Yokohama Specie Bank was designated as the foreign exchange agent bank of the central institutions set up by Japanese-dominated Governments; namely, the Bank of Mongolia in northwestern China, the Federal Reserve Bank of China in northern China and the Central Reserve Bank of China in central China. The Yokohama Specie Bank was put in charge of the monetary reserves and foreign exchange accounts of these central banks and entrusted with the foreign exchange control operations. In northern China, the foreign exchange regulations required exporters to sell their foreign bills through

[8] The Maritime Customs, *The Trade of China*, Shanghai, 1938, Vol. I., pp. 16-8.

the Yokohama Specie Bank at the official rate ($0.234375 per FR$1.00) and importers to apply for a "certificate for buying foreign exchange" and to negotiate the exchange through the Yokohama Specie Bank, acting for account of the Federal Reserve Bank of China. The Yokohama Specie Bank was authorized to make available to the exporters 90 per cent of their export exchange for sale to importers of certain "approved" goods; this "link" business was transacted at various rates, exporters taking advantage of the difference between the official rate ($0.234375) and the "minimum permissible link" rate of $0.13875 per FR$1.00. Similar measures were introduced in northwestern China. It was also provided that, as a condition for permitting the re-export of Japanese goods from occupied China to third countries, drafts should be issued through Japanese banks; this aimed at preventing the free disposal of foreign credits arising from such trading.

Consequently, the Yokohama Specie Bank assumed in the occupied territories of China the functions which it had always performed in Japan—that is, of acting as a special institution for international trade and as the foreign department of the central bank. Its branches were therefore called upon to act as agencies of the Bank of Japan in occupied China. This involved the custody, receipt and disbursement of official funds and the management of the Bank of Japan notes.[9] Moreover, the Yokohama Specie Bank was entrusted with the administration of new Japanese loans to China, which included: (a) a working credit of ¥100 million, advanced in 1938 to the Federal Reserve Bank of China through a banking syndicate formed by the Yokohama Specie Bank, the Bank of Chosen and the Industrial Bank of Japan; (b) a working credit of ¥15 million, advanced in 1940 to the Bank of Mongolia, through a banking syndicate formed by the Yokohama Specie Bank, the Bank of Chosen and the Industrial Bank of Japan;[10] (c) a loan of ¥300

[9] Large amounts of Bank of Japan notes (chiefly one-yen bills) were placed into circulation in the occupied areas late in 1937 and during 1938. These notes were not convertible into foreign exchange and were marked to indicate that their circulation in the Japanese Empire was not permitted. Late in 1938, holders were required to exchange the bank notes for military yen notes; the Bank of Japan notes (only small amounts of which remained in circulation at Shanghai in 1941) gained a slight premium over the military notes.

[10] The working credits granted to the two central banks carried an annual interest rate of 4.562 per cent and were secured by bonds issued by the Japanese-dominated Governments of North China and Mongolia.

million, made in 1941 by the Japanese Government to the new "National" Government of China at Nanking.

The operations of the Yokohama Specie Bank in China expanded correspondingly. A new office was opened in Kalgan, its domestic and exchange funds expanded, the turnover of foreign exchange transactions for business requirements and coverage for forward operations of Chinese and Japanese banks increased and foreign traders found it convenient to establish business accounts with its branches.[11] The business gained by the Yokohama Specie Bank in China was taken away chiefly from the Central Bank of China, the Bank of China and the Hongkong and Shanghai Banking Corporation; however, under the restrictions imposed in the occupied areas, other foreign banks (including American) found it difficult to carry on trade financing.

The other Japanese official banks also obtained some of the privileges granted to the Yokohama Specie Bank. The Bank of Chosen and the Bank of Taiwan were entrusted with functions pertaining to foreign exchange control in northern and southern China, respectively. The Bank of Chosen was placed in charge of the financing of trade and handling of funds for the Japanese Army. The circulation of its notes in China, which was estimated at around ¥3 million in northern China prior to the outbreak of hostilities, increased manyfold during 1937 and 1938 and extended to the Yangtze region.[12] In 1939, however, the Bank of Chosen endeavored to withdraw its notes from circulation in northern China, and all Japanese banks adopted a policy of converting yen deposits, making loans and exchanging remittance drafts and letters of credit in the currency of the Federal Reserve Bank of China. A similar policy was adopted by the Central Bank of Manchou, which in 1940 entered into an agreement with the Federal Reserve Bank of China for the withdrawal and conversion of its notes circulating in northern China.

Branches of private exchange banks (Mitsui, Mitsubishi,

[11] Several foreign exporters established military yen accounts with branches of the Yokohama Specie Bank, the opening of these accounts being necessary in order to obtain export permits from Japanese military authorities. *Finance and Commerce,* August 27, 1941.

[12] *Japan-Manchoukuo Yearbook,* 1940, pp. 879 and 893. The amount of Bank of Chosen notes in circulation in North China at the beginning of 1938 was estimated at ¥60 million. *Foreign Financial News,* March 19, 1938.

Sumitomo) made no significant progress, since they failed to participate to any great extent in the trade business of the Japanese Army and they were handicapped in competing with official institutions, which operated on illiquid liabilities at low interest. Local banking and non-banking institutions expanded along with the growth of Japanese communities and enterprises in China. The Hankow Bank, with its head office in Hankow, branches in Nanking and Shanghai, and business connections in all occupied parts of Honan, raised its capital from ¥1 million to ¥3 million at the beginning of 1941.[13] In some cities (Tsingtao, for instance), mutual credit and savings associations developed into important financial agencies, which provided commercial and consumption credit to Japanese residents.

The investments in basic industries in northern and central China were entrusted exclusively to two semi-official holding companies. The North China and Central China Development Companies were established in November 1938 under special authority of the Japanese Diet—the former being capitalized at ¥350 million and the latter at ¥100 million, half of which was paid in by the Japanese Government. The functions of the companies included issuing debentures in the Japanese and Chinese capital markets and investing money in, or advancing funds to, the following enterprises:

1) Transportation, ports and harbors;
2) Communications;
3) Electric, gas and waterworks;
4) Mining;
5) Salt and aquatic products industry;
6) Enterprises necessary for promoting the economic development of northern and central China.

At the end of 1940, the North China Development Company held shares of twenty-six affiliated companies and associations for a total amount of ¥244 million and had outstanding loans and advances to all subsidiary enterprises totaling ¥368 million of debentures and ¥23 million of loans. In the distribution of investment funds, transportation, communication and harbor enterprises accounted for the major portion (73 per cent), followed by mining (9 per cent) and electric enterprises (6 per cent).[14] The investments in and loans to fourteen subsidiary en-

[13] *Finance and Commerce*, April 21, 1941.
[14] *The Oriental Economist*, August, 1941, pp. 407-10.

terprises by the Central China Development Company, at the end of 1940, amounted to ¥51 million and ¥48 million, respectively.[15] Since the North China and the Central China Development Companies were holding institutions, the industrial management was left in the hands of affiliated and subsidiary companies.[16] These operating companies were legally Sino-Japanese concerns, Chinese capital being represented by the value of the properties formerly belonging to Chinese companies. The system provided, therefore, for the use of Chinese capital under Japanese control.[17]

The inclusion of the Federal Reserve Bank of China currency in the yen monetary bloc brought about a strict enforcement of the Japanese Capital Control Law and other financial measures in northern China. The approval of Japan's Economic Commissioner at Peiping was required of Japanese residents in order to establish credit associations. Industrial investments in and the financing of business enterprises were subjected to various restrictions. The Yokohama Specie Bank and the Bank of Chosen were required to obtain prior approval of Japan's Financial Commissioner at Peiping for loans between FR$100,000 and FR$500,000 and to obtain the authorization of the Ministry of Finance at Tokyo for loans above the latter amount.[18]

Other European Banks. The foreign banks of European nationalities (French, Belgian, Dutch, German and Italian)[19]

[15] Fong, H. D., *The Post War Industrialization of China,* Washington, 1942, p. 49.

[16] Under special circumstances, however, the Central China Development Company could manage directly any of its affiliated or subsidiary enterprises.

[17] With the occupation of China's coastal provinces, Japanese military authorities took control of Chinese enterprises and deprived the legal owners of the exercise of their property rights. In an "understanding" attached to a protocol of the treaty signed in November 1940 between Japan and the Republic of China (Nanking), provision was made for measures intended to promote "the prompt transfer to Chinese management in a rational manner" of the industrial, mining and commercial establishments controlled by Japanese forces. However, little headway was made in this direction.

[18] *Foreign Financial News,* August 4, 1940.

[19] In 1940 the following European banks were operating in China:

French: Banque de l'Indochine, Crédit Foncier pour l'Extrème Orient, Banque Franco-Chinoise pour le Commerce et l'Industrie, Union Mobilière Société Française de Banque et de Placement;

Belgian: Banque Belge pour l'Etranger Extrème Orient;

Dutch: Nederlandsche Handel-Maatschappij, Nederlandsch Indische Handelsbank;

German: Deutsch-Asiatische Bank;

Italian: Banca Italiana per la Cina.

reaped profits from foreign exchange transactions in the Shanghai market, but they were seriously affected by the political developments of the war situation. The sharp contraction of trade with continental Europe and the restrictions against commercial and financial intercourse with enemy nationals made it impossible for the Chinese offices of these banks to maintain established business contacts. Their field was further restricted by the United States "freezing" of European assets (those of the Netherlands and Belgium on May 10, 1940; France on June 17, 1940; Germany and Italy on June 14, 1941). These restrictions disrupted business relations between American institutions and Belgian, French, German and Italian banks. The Dutch banks, however, were less handicapped, since their branches were granted a general license by the United States Treasury on May 31, 1940.[20]

FINANCIAL WARFARE IN THE PACIFIC: JULY—DECEMBER 1941

Financial warfare in the Pacific area is not new. Early in this century foreign powers fought with political loans and railway investments for the conquest of "spheres of interest" in decaying China. After 1935 a battle of currencies had developed between the national yuan on the one hand, defended by China's strong will to resist and assisted by sterling and dollar credits, and, on the other hand, the yen, supported by the military might of Japan and backed by the dollars provided through unrestricted purchases of Japanese gold by the United States. The orders—known as "freezing" orders—issued by the Governments of the United States, the British Empire and the Netherlands (East) Indies with regard to Japan and China, as well as the retaliatory measures taken by the Japanese authorities and the Japanese-controlled Governments in China, resulted in severing the relations existing between Japanese financial and economic interests and American, British and Dutch institutions in China.

American, British and Dutch Freezing of Japanese and Chinese Assets. Executive Order No. 8832, issued by President Roosevelt on July 26, 1941, placed China and Japan on the list of countries whose assets subject to the jurisdiction of the

[20] Special facilities under "blanket" or "special" licenses were also temporarily granted by the United States Treasury to some French and Belgian banks.

United States[21] were frozen. The order prohibited, except as specifically authorized by the Secretary of the Treasury, all transfers of credit between banking institutions; all transactions in foreign exchange; the export, withdrawal or earmarking of gold or silver coin or bullion or currency; all transfers, withdrawals or exportation of, or dealing in, any evidence of ownership of property (including bank deposits, savings accounts, banking and credit instruments); and any transactions for the purpose (or with the effect) of evading the foregoing prohibitions, if such transactions were by any institution and/or person subject to the jurisdiction of the United States and involved Chinese and Japanese authorities or nationals, or property in which Chinese and Japanese authorities and/or nationals had at any time on or since June 14, 1941, had any interest of any nature whatsoever, direct or indirect.

On July 26, 1941, the British Treasury, acting under the Defense (Finance) Regulations of 1939, issued directions to bankers prohibiting the carrying out of orders given by or on behalf of the Japanese Empire and the Republic of China, or by nationals thereof, affecting Japanese and Chinese balances, gold and securities in the United Kingdom. Corresponding action was taken by all other Governments (colonies, mandates and dominions) of the British Empire. Simultaneously Hongkong was brought within the sterling area, and all Chinese and Japanese assets in the island were frozen.

On July 28, 1941, the Government of the Netherlands (East) Indies issued regulations suspending and placing under a license system all foreign exchange transactions between Dutch and Japanese banks; however, the regulations failed to include transactions on Chinese account.

Retaliatory Measures Taken by the Japanese Government and by Japanese-Controlled Authorities in China. On July 28, 1941, the Japanese Ministry of Finance issued an ordinance under authority of the Foreign Exchange Law of 1933, setting forth in thirty-one articles "regulations for the control of transactions concerned with foreign nationals." The ordinance affected nationals, juridical persons and residents of nations designated by the Ministry of Finance; the list of designated

[21] As used in the Executive Orders, the term "United States" meant the United States and any place subject to the jurisdiction thereof; the term applied to the United States possessions and to the Philippine Islands.

nations included the United States, the Philippines, the United Kingdom, the dominions, mandates and colonies of the British Empire, the Netherlands and the Netherlands (East) Indies. Japanese banks were specifically forbidden to effect transactions with American, British and Dutch nationals and institutions, which involved the acquisition, transfer or disposal of negotiable instruments, domestic and foreign currencies, domestic and foreign credits, debts or guarantees of debts, deposits, investments and any other property or property rights.[22]

The Tokyo ordinance was immediately followed by identical orders issued by Japanese and Japanese-dominated authorities in China. A freezing ordinance was issued by the North China Political Council, on July 28, 1941, as a "necessary countermeasure, in view of the action of the United States and Great Britain in freezing the assets of China and her friendly neighbors." The seventieth meeting of the Executive Yuan of the "National Government of the Republic of China" at Nanking discussed, adopted and promulgated on July 30 "regulations governing the disposition of assets of designated persons." Identical orders were issued by the Japanese-appointed mayors of Hankow, Amoy and other Chinese cities, and similar steps were taken by the Japanese military authorities in all parts of occupied China. Needless to say, all these measures were merely a copy of the ordinance compiled by the Ministry of Finance at Tokyo.

The Application of the Freezing Policy. While American and British regulations provided for a blocking of dollar and sterling balances due to "nationals" of China,[23] they were not intended to block purely domestic national yuan transactions performed by branches of American and British banks in China. However, domestic national yuan operations between American, British or Dutch banks and Japanese or Chinese banks were subjected to the restrictive measures imposed by Japanese and Japanese-dominated authorities in occupied territories. Moreover, while the freezing of Japanese assets by the Ameri-

[22] *Tokyo Gazette*, September, 1941, pp. 139-43.

[23] As used in the United States Executive Orders, the term "national of China" includes; (a) any person domiciled in, or a subject, citizen, or resident of China; (b) any partnership, association, corporation, or other organization, organized under the laws of or which has its principal place of business in China, or which is controlled by or a substantial part of the capital or other liabilities of which is owned or controlled, directly or indirectly, by China or Chinese nationals; (c) any person to the extent that such person is acting directly or indirectly for the benefit or on behalf of a national of China.

can, British and Dutch authorities was based upon the well-established principles of protection and repression ("to prevent the use of financial facilities . . . and trade . . . in ways harmful to national defense and interests, to prevent the liquidation . . . of assets obtained by duress and conquest, and to curb subversive activities"), the freezing of Chinese assets was decided "in accordance with the wishes of the Chinese Government."[24] This different basic consideration brought about differing administrations of the freezing orders with regard to free and occupied China.

The freezing orders were applied by the United States and the British Empire with a view:

(a) to placing a virtual embargo on financial transactions of Japanese nationals and Japanese-owned and controlled institutions in China with the dollar-sterling areas; and
(b) to enforce a foreign exchange control of the national yuan.

The principle was adopted, therefore, of granting no licenses for official funds held by the Yokohama Specie Bank or other Japanese banks for account of Japanese and Japanese-dominated authorities, including the new central banks established in occupied territories; other funds could be released to "nationals" of China only through the special licensing procedure. Official funds of the National Government of China at Chungking were freed from all restrictions as a matter of general policy.[25] The administration of the control over foreign exchange transactions between the national yuan and the dollar-sterling currencies was entrusted to an international agency, the Stabilization Board of China. American, British and Dutch banks were called upon to play an important part in this policy, as may be explained by examining the general licenses, supplementary regulations and other measures governing China's financial foreign relations after July 1941.

The Stabilization Board of China. The Stabilization Board

[24] Press releases from the United States Treasury (July 26, 1941) and British Treasury (July 28, 1941).

[25] United States Treasury General Licenses Nos. 60, 61 and 62 authorized any transactions engaged in by the National Government of the Republic of China, the Central Bank of China, the Bank of China, the Bank of Communications, the Farmers' Bank of China, the China Defense Supplies, Inc., and the Universal Trading Corporation. Instructions were issued by the central banks of the British Empire, releasing from the effect of the freezing orders certain accounts of persons and firms resident in those parts of China which were not under Japanese occupation or control.

of China was officially organized on August 13, 1941, its original function being the management of the Yuan Stabilization Fund which had been set up on April 25, 1941, with credits of $20 million contributed by the Chinese Government banks, $50 million granted by the United States Stabilization Fund and £5 million advanced by the British Treasury. Although the Board was, from a legal point of view, an agency of the National Government of the Republic of China, its authority was derived from the recognition and co-operation of the American and British Governments.[26] Even before the American and British monetary assistance was announced on November 30, 1940, it was generally understood that continued support of the national yuan in the Shanghai open market would exhaust China's foreign financial resources and result in a diversion of part of them for Japanese use. Despite this, foreign exchange control could not be enforced by the National Government in occupied and extraterritorial areas or against foreign nationals. The freezing of Chinese assets by the two largest currency areas of the world made it possible to enforce, through the American and British licensing system, restrictions on yuan-dollar and yuan-sterling transactions. Consequently, the Stabilization Board became less a monetary authority and more an administrative and consulting agency for the application of the freezing orders to China. Foreign banks were called upon to play an increasingly important role in the stabilization of the national yuan.

United States Treasury General Licenses Nos. 58 and 59, issued on July 26, 1941, freed from the freezing limitations (a) all imports and exports and incidental transactions between China and territories subject to the jurisdiction of the United States, the American Republics, the British Empire, the U.S.S.R. and the Netherlands (East) Indies, and (b) the American, British and Dutch banking corporations in China. This unrestricted system proved to be most unsatisfactory, owing to the special conditions existing in occupied China; therefore, on September 6, 1941, the American and British Treasuries requested banks in the Far East to give their full co-operation to the Stabilization Board. On September 8, American and British

[26] The administrative set-up of the new fund was similar to that of the Chinese-British Stabilization Fund. The new board consisted of five members—three Chinese, one American and one Britisher appointed by the National Government of China.

banks in Hongkong and Shanghai announced that they had agreed to co-operate fully for the maintenance of the buying and selling rates fixed by the Board. Consequently, all dealings were suspended in the open market by licensed banks, as the banks agreed to grant exchange for legitimate purposes only, at the official rates.

The licenses were amended on November 12, 1941. General License No. 58, as amended, required that all trade between the United States and China be cleared through the Stabilization Board or its authorized agents. The license covered all exports from the United States to China, providing the importer had obtained the dollar exchange from an "appointed bank," and all imports into the United States from China, providing the exporter had completed arrangements for selling the dollar exchange to an "appointed bank." The term "appointed bank" was defined as "any of those banks co-operating with the Stabilization Board and buying and selling foreign exchange with the permission of, and subject to the conditions prescribed by, such Board."

In General License No. 59, as amended, the offices within Hongkong and any part of China (except Manchuria) of the following banks were named "appointed banks":

American: The Chase Bank, National City Bank of New York, Underwriters Bank for the Far East, American Express Company, Inc.;
British: Moscow Narodny Bank, Ltd., Thos. Cook and Son (Bankers), Ltd., Hongkong and Shanghai Banking Corporation, Mercantile Bank of India, Ltd., David Sassoon and Co., Ltd., E. D. Sassoon and Co., Ltd., E. D. Sassoon Banking Co., Ltd., Chartered Bank of India, Australia and China, Ltd.;
Dutch: Nederlansch Indische Handelsbank, Nederlandsche Handel-Maatschappij;
Chinese: Shanghai Commercial and Savings Bank, Ltd., Bank of East Asia, Ltd., National Commercial Bank, Ltd., Chekiang Industrial Bank, Ltd., Bank of Canton, Ltd., Oversea-Chinese Banking Corporation, Ltd., Kincheng Banking Corporation, China Banking Corporation, Bank of China, Bank of Communications, Farmers Bank of China, Central Bank of China.

Simultaneously, United States General License No. 75 authorized all remittances from the United States to China, provided the dollar amount be paid to a designated agent of the Central Bank of China (Bank of China or Philippine Bank of Communications) for account of an "appointed bank."

As a result of these regulations, the appointed banks were made the collecting and disbursing agencies of the Stabilization Board. Beginning November 13, 1941, all dollar exchange received by the appointed banks through trade with or remittances from the United States was to be made available to the Stabilization Board upon demand against delivery of national currency. On the other hand, the Stabilization Board guaranteed exchange cover to the banks for all approved trade and remittance transactions. The Stabilization Board reserved to itself the right: (a) to fix the rate of exchange at which transactions could be effected, (b) to decide upon applications for exchange exceeding ordinary transactions and (c) to determine exchange allotments for classes or types of imports.

The United States general licenses represented a co-operative effort on the part of American and Chinese authorities for enforcing an administrative control over dollar-yuan transactions. They were supplemented, on November 6, by regulations issued by the colonial Government of Hongkong "in conjunction with the Ministry of Finance of the National Government of China and the Stabilization Board of China," with a view to assisting "in carrying out the currency policy of the National Government of China." These regulations prohibited, except by special permit, any exchange transaction involving national currency; the holding, import and export of any national currency notes, and any exchange transaction in notes issued by a bank, bills of exchange, promissory notes, deposit receipts or entries in account book, expressed in terms of national currency. The offices of the "appointed banks" in the island were exempted from the restrictions. All banks were required to quote only official rates for national currency and to submit applications for exchange to the Stabilization Board for approval. Between the end of November and the beginning of December 1941, the British Treasury took similar steps. It instructed British banks to co-operate with Chinese authorities in the use of exchange arising from financial remittances to China, and it asked them to open accounts with the Bank of China, London branch, with a view to centralizing all sterling-yuan transactions there.

As a result of these measures, the operations of American, British and Dutch banks in China were confined to the financing of legitimate trade and remittances and subjected to the

control of the Stabilization Board. In their new position, which has been defined as one of "necessary co-operation" with Chinese authorities, foreign banks moved a step toward subordinating their activities to such decisions of policy as might be made by Chinese-foreign Government bodies. At the turning point in the Pacific situation, the National Government was assured of financial co-operation from friendly powers far beyond the mere granting of credits. Once before, in recent Chinese history, the close co-ordination of British administrative measures and the subordination of American interests to Chinese laws and regulations proved to be the essential elements of success; namely, in the monetary reform of 1935.

CONCLUSION

When Japan went to war with the United States and the British and Dutch Empires, on December 7, 1941, the financial and economic warfare inaugurated four months earlier was being carried on over the bank counters of Shanghai and Hongkong. Under the impact of the war, all business of American, British and Dutch communities in Japanese-occupied China was brought to a standstill. The status of "appointed banks" of offices of foreign and Chinese banks in enemy-occupied areas was revoked by the United States Treasury on December 26, 1941; consequently, trade and remittance operations from the United States, the British Empire and the Netherlands (East) Indies were restricted to free China.

The liquidation of American, British, Dutch and Belgian banks in Japanese-occupied China and Hongkong was entrusted to the Yokohama Specie Bank, in co-operation with the Bank of Taiwan and the Mitsubishi Bank. All deposit accounts were transferred to the Japanese banks; citizens of non-belligerent countries were allowed to withdraw their deposits fully in accordance with the dividends gradually paid by the banks on the accounts, while citizens of enemy countries were allowed to withdraw only up to CN$2,000 a month. Banks of neutral or friendly nationalities (French, German and Italian) continued to operate; however, owing to the war situation, the activities of these banks were confined to local financing of a domestic, rather than foreign, type. The Shanghai Foreign Exchange Bankers Association was reorganized in August 1942, under the leadership of the Yokohama Specie Bank with a

membership of ten banks (six Japanese, two French, one German and one Italian).

Japanese banks were the only institutions left with connections outside China, and as a consequence they were placed in a position to dominate foreign financial relations. In particular, the Yokohama Specie Bank was entrusted with the financing of trade between occupied China and the occupied regions of southeastern Asia. Foreign financial transactions were effected according to the official rate of the military yen in Shanghai, which was fixed on the basis of the national currency at CN$4.00 in December 1941 and on the basis of Central Reserve Currency at CR$4.00 in March 1942. In the free market, however, the military yen showed a constant tendency to appreciate above the official rate.

Despite any local and temporary advantages gained by Japanese banking, the eventual status of the foreign money market in China is dependent upon the outcome of war and China's own economic and financial policies.

CHAPTER XI

THE MODERN MONEY MARKET

The Japanese occupation of China's northern and coastal provinces and the slashing of the country into two political zones disrupted the process of financial and monetary unification which had been successfully carried on by the National Government between 1935 and 1937. A study of the Chinese modern money market after July 1937 therefore requires separate analyses of the conditions prevailing in free and occupied territories. Official authorities of free and occupied China followed parallel courses of State capitalism, and the development of modern financial institutions in both zones continued to be dependent upon political initiative. As a "no man's land," outside the jurisdiction of the Chinese law, the foreign areas in Shanghai offered trading opportunities to Free China's institutions, as well as to those institutions registered under Japanese-dominated authorities.

THE MODERN MONEY MARKET OF FREE CHINA

THE CENTRAL BANKING GROUP

The Joint Loan and Discount Committee. Although final enactment of the Draft Law of the Central Reserve Bank of China (approved by committees of the Legislative Yuan in June 1937) was delayed and suspended by the opening of the Sino-Japanese hostilities, measures were soon enforced by the National Government with a view to insuring the concentration of central banking functions. In August 1937 the Ministry of Finance instructed the four Government banks (the Central Bank of China, the Bank of China, the Bank of Communications and the Farmers Bank of China) to organize a Joint Loan and Discount Committee, with its head office in Shanghai and branch offices in leading commercial centers (Nanking, Hankow, Kaifeng, Canton, Chungking, etc.). The functions of this organ were to regulate credit and stabilize money market conditions. The branch offices, or Joint Loan and Discount Sub-Commit-

tees, were charged with the direction of local operations of the four banks on the basis of general working principles prepared by the Joint Committee's head office. Whenever possible, the sub-committees were also expected to adapt their loan and discount policy to meet requirements peculiar to the local communities; if necesssary, they were to submit a special report to the Committee and await specific instructions. In Shanghai, the Committee extended cash loans to banks against collateral security and also rediscounted commercial bills. The credit extended by the Committee (as of the end of 1937) amounted to CN$89 million, which enabled Chinese banks to deal with the emergency smoothly and effectively.[1]

The Joint Administration of the Four Government Banks. The establishment of this committee was a step toward setting up a central organ for the direction and management of central banking credit, but it left unsolved certain problems arising from duplication in the direction of the institutions entrusted with central banking functions. A Joint Administration of the four Government banks was therefore organized by law on September 8, 1939; its board of directors was formed by the governor and deputy-governor of the Central Bank of China, the chairmen or general managers of the Bank of China, the Bank of Communications and the Farmers Bank of China and a representative of the Ministry of Finance. The Central Trust of China (a subsidiary of the Central Bank of China) and the Postal Remittances and Savings Bank (an autonomous agency under the supervision of the Ministry of Communications) were also admitted to participation in the operations of the Joint Administration. The wide scope of the activities of the Administration can be seen from the following outline of its organization:

ORGANIZATION OF THE JOINT ADMINISTRATION OF THE FOUR GOVERNMENT BANKS MANAGING BOARD OF DIRECTORS

Wartime Economic Commission	*Wartime Financial Commission*	*Secretariat*
Bureau of Special Investment	Bureau of Issue	Secretarial Staff
Bureau of Materials and Resources	Bureau of Discounts	Statistical Staff
Bureau for Price Stabilization	Bureau of Remittances	
	Bureau for Special Savings	
	Bureau for Collection and Purchase of Precious Metals	

[1] Chu, Percy, "Shanghai Financial Problems in Wartime," *Finance and Commerce,* April 12, 1939.

In fact, the Joint Administration was charged with the responsibility of directing the various activities connected with the wartime financial policy of the National Government; this involved the following duties:

(a) Adjustment of the note issue among the four banks;
(b) Issue and distribution of subsidiary notes;
(c) Inspection of note reserves of the four banks;
(d) Collection and exchange of gold and silver;
(e) Approval of applications for foreign exchange by importers;
(f) Control of remittances to and from interior and coastal cities;
(g) Planning and distribution of a network of financial agencies;
(h) Promotion of special savings and deposits;
(i) Centralization and utilization of capital funds;
(j) Joint investments in wartime productive enterprises;
(k) Joint granting of loans and discounts;
(l) Direction of other joint activities of the four banks;
(m) Auditing of budgetary estimates, receipts and disbursements of the four banks.

In addition, the chairman of the board of the Joint Administration, Generalissimo Chiang Kai-shek, was empowered "to formulate measures that facilitate the activities of the four Government banks and to asssume their powers and responsibilities in abnormal times."

The Joint Administration considerably speeded up the financial and economic development of the interior. At the end of March 1940, the four Government banks had 236 offices spread over 132 localities of free China, while sixty additional offices were expected to be established; these formed a network of strategic centers for general economic mobilization. It was reported that, at the end of 1940, loans granted by the four banks through the Joint Administration amounted to CN$700 million; this sum was probably doubled during 1941. The Central Bank of China and the Bank of China held 70 per cent of the total outstanding at the end of 1940, while the Bank of Communications and the Farmers Bank of China had taken up 20 per cent and 10 per cent, respectively. Of this amount, more than CN$150 million went to factories in the interior; most of this sum was invested in Government-owned industries.[2] The percentage distribution, by kinds, of the investments made and credits advanced by the Joint Administration from

[2] *The Central Bank of China Bulletin*, Summer 1941, p. 217.

March to December 1940, totaling CN$855.9 million (exclusive of financial assistance to agriculture), is shown in table 31.

TABLE 31

INVESTMENTS AND CREDITS OF THE JOINT ADMINISTRATION

March–December, 1940

Percentage Distribution

Salt Administration and manufacturers	29.63
Industry and mining (Government and private)	20.41
Purchase and sale of commodities for price stabilization	16.05
Storage of foodstuffs for military and civilian uses	8.99
Provincial governments and financial institutions, including banks	8.78
Communications, including highways, railways, steamboats and broadcasting facilities	2.94
Evacuation and construction of Greater Chungking	1.00
Others, including loans to educational institutions and press	12.20
Total	100.00

Source: The Central Bank of China Bulletin, Autumn 1941, p. 356.

Loans to agriculture were made according to plans drawn by a Government agency for agricultural planning, the Agricultural Credit Administration. These loans totaled CN$151.3 million for the period from June 1939 to February 1940, CN$209.5 million for 1940, and CN$498.6 million for 1941. Total loans outstanding at the end of 1941 amounted to CN$465.3 million. About 90 per cent of these loans were used for agricultural production, being granted chiefly through co-operative societies and co-operative banks; the balance was used for financing granaries, experimental farms, irrigation and other miscellaneous projects. The participation of the various lending institutions was reported as follows: Farmers Bank of China, 47 per cent; Bank of China, 39 per cent; Bank of Communications, 8 per cent; Central Trust of China, 6 per cent.

The four Government banks were required by the board of directors of the Joint Administration to establish their head offices in the capital (Chungking) before a definite date; thus the first steps were taken for the development of a financial center in free China. In March 1941, the Ministry of Finance instructed the Central Bank of China to provide foreign exchange facilities at Chungking, Kunming and other centers; it was argued that if a foreign exchange market could be set up in the interior, it would automatically develop a trade market, to which merchandise would increasingly be attracted by the

ready exchangeability of Chinese and foreign currencies. The policy of the Joint Administration reflected a fundamental trend in China's wartime development; namely, the tendency to shift the financial center from Shanghai to the interior. A Chinese economist describes the bearing of this policy upon China's postwar economic and financial development as follows:

"As a result of the development of a network of financial institutions in the interior, all radiating toward the major center at Chungking and secondary centers in other cities in the hinterland, the economic life of the nation would gravitate away from Shanghai toward free China. China would thus be freed from the denationalizing influence of Shanghai, which, as the stronghold of foreign power, is the natural financial center of a semi-colonial China. If China succeeds in bringing about this shifting of her economic and financial center from foreign-dominated Shanghai to a locality where she can exercise full control, she would have taken a long step in the transition from a semi-colonial status to that of a full-fledged independent nation.

"It is true that the geographical advantage of Shanghai will insure it a place of permanent importance in the commerce and industry of China once the war ends and connections with its hinterland are re-established. But as long as it is under any kind of foreign influence, it will be to China's advantage to develop and maintain rival centers in the interior. Even if foreign influence completely disappears from Shanghai, and it regains its position as a leading economic and financial center, it will be wise for China, in the interests both of national defense and of the welfare of the whole population, to develop the interior center as a means of correcting the lop-sided character of its pre-war economy."

Operations of the Central Banking Group. The creation of the Joint Administration fell short of establishing a unified central banking institution. Article 2 of the Regulations of the Joint Administration provided that "the four Government banks shall continue to perform separately their respective functions and develop their banking business as specifically provided in their respective banking charters." Prior to 1937, central banking operations were scattered rather indiscriminately among the Government banks. The war, far from bringing about a specialization of business among the four banks, led to an expansion in all their functions; only after the middle of 1941, the Central Bank of China took the lead as the policy-making institution. Therefore, although a central organ of direction was established, the problems arising from duplications in the organization and activities of the banks remained substan-

tially unaltered. Throughout the war, only the Bank of China regularly issued its annual statement of condition; the Bank of Communications apparently suspended publication of its own balance sheet after 1938; the Central Bank of China and the Farmers Bank of China failed to disclose the figures of their balance sheets after 1936.

TABLE 32

ASSETS AND LIABILITIES OF THE BANK OF CHINA

December 31, 1936–1940

(In thousands of national yuan)

	1936	*1937*	*1938*	*1939*	*1940*
Assets					
Cash on hand	307,866	357,818	436,915	741,437	1,081,966
Loans, discounts, overdrafts	909,560	938,978	1,412,702	2,945,135	3,061,457
Investments	45,174	74,130	82,934	110,978	189,397
Bank premises	10,707	13,274	13,036	13,346	14,521
Other assets	64,050	90,845	65,463	102,669	161,695
Net loss	..	1,047	..	..	..
Reserve against notes in circulation	465,691	617,429	711,825	771,997	1,562,080
Liabilities					
Paid-up capital	40,000	40,000	40,000	40,000	40,000
Reserve funds	4,914	5,350	3,236	4,373	4,507
Deposits	1,206,305	1,306,816	1,857,301	3,654,164	4,061,227
Drafts issued	19,252	33,041	43,080	110,155	239,298
Other liabilities	64,050	90,845	65,463	102,668	161,695
Net profits	2,836	..	1,970	2,205	2,339
Notes in circulation	465,691	617,429	711,825	771,997	1,562,080
Total Assets/Liabilities	1,803,048	2,093,481	2,722,875	4,685,562	6,071,146

Note: See note to Table 9.
Source: *Annual Reports of the Bank of China.*

While the exact figures were not disclosed, it is estimated that at the end of 1940 loans of the four Government banks amounted to about CN$10,000 million (as compared with CN$2,142 million at the end of 1936), while their deposits totaled some CN$8,000 million (as compared with CN$2,673 million at the end of 1936), of which CN$1,500 million represented current accounts accrued to the banks during 1940 only.[3] In September 1939, as a measure to encourage savings among the people, the four banks were authorized to issue Thrift and Reconstruction Savings Certificates, carrying annual interest of 6 to 9 per cent for periods from one to ten years, and to receive fixed savings accounts in foreign currencies and in national currency, carrying annual interest of 2 to 7 per cent, with exchange guarantee. In 1940 the Gov-

[3] *The Central Bank of China Bulletin,* Spring 1941, p. 97.

ernment banks revised the scale of interest, setting rates at 5 to 10 per cent on current and fixed savings accounts and at 8 to 12 per cent on savings certificates. In March 1942, the National Government instructed the four Government banks and the Postal Remittances and Savings Bank to issue up to $100 million of savings certificates, secured by a dollar credit from the $500 million American loan of 1942, purchasable with national currency at the rate of CN$100 for $5 and redeemable in periods of one, two and three years.

These efforts, however, were not entirely successful and the expansion in current liabilities of the banks accurately reflects the inflationary trend of the Chinese economy during the war. Even China's moderate pre-war deficits, amounting to CN$200 million or CN$300 million annually, could hardly have been incurred without some degree of monetary expansion, and it is evident that the new rate of expenditures under war conditions certainly could not have been achieved without recourse to artificial creations of purchasing power by the State. Receipts from taxation, hypothecation of future revenue in the form of foreign credits and borrowing from the savings of a greatly reduced population and a limping economy could never have placed in the hands of the National Government the exceptional amount of purchasing power needed to carry on the economic, as well as the military, resistance to Japan. It is believed that the cost of the National Government during the first four and a half years of war (July 1937-December 1941) totaled some CN$25,000 million, rising from CN$2,000 million for the year 1937 to about CN$10,000 million for 1941; revenue from taxation, receipts from the issuance of foreign currency bonds and the use of foreign credits probably furnished the National Government with an income not exceeding 40 or 50 per cent of its total outlay. Borrowing from the banks of issue and, in consequence, money printing, represented the alternative method of filling the monetary gap.

The technique of deficit financing followed the traditional pattern; i.e., the four Government banks granted loans and made advances to the National Government and its agencies—these short and middle term credits were eventually settled, when due, through the delivery of long term Government bonds by the Ministry of Finance. During the first four and a half years of the war, Government bonds in national cur-

rency were reportedly authorized and/or issued up to CN$3,430 million, and the Government had to obtain advances from the four Government banks and other banks to cover a deficit of CN$10,000 million to CN$15,000 million. It may be assumed that banks found it difficult to unload any significant amount of their holdings of bonds in the market, with the consequence that the issuance of new loans failed to bring about any contraction of the currency placed in circulation as a result of the original advances.

After 1937, financing of Government deficits was undoubtedly the main function of the central banking group; it was the most important factor in the steady rise of the note circulation. However, in a system of State capitalism such as China has had since 1927, Government deficits due to military expenditures cannot be dissociated from Government deficits due to investments and other outlays for economic development. Unquestionably, the four banks played a decisive role in financing, directly and indirectly, individually and collectively, the development of free China's war economy.

In the industrial field, CN$10.4 million, or 65 per cent of the capital of industrial co-operatives—the skeleton of a guerrilla industry—was reportedly invested by the Government banks as of March 30, 1942, the balance being supplied by Government appropriations, private means and members' subscriptions. Supplementary working funds were provided almost exclusively by the Government banks in the form of short-term loans (up to one year) at annual interest of eight per cent; and fixed loans, running from one to five years, at annual interest of six per cent, were secured on the entire assets of the borrowing co-operative units. At the end of 1941, it was reported that lending by the Government banks to industrial co-operatives amounted to over CN$20 million, of which the largest part was provided by the Bank of China; in June 1942 the granting of more bank credit, to the extent of CN$40 million, was decided upon. The financing of modern State-owned and private industries, such as manufacturing, public utilities, mining, etc., in the western and southwestern provinces was entrusted to the Government banks, particularly the Bank of China and the Bank of Communications; the latter assisted the National Government in financing the construction

of about 2,000 miles of highways and 200 miles of railways during the first three and a half years of war.

In the agricultural field, the operations of the four banks were closely connected with those of the Agricultural Credit Administration. The Farmers Bank of China led the other banks in the task of rural rehabilitation. By the end of 1941 the bank had extended over CN$460 million, including investments in, and the promotion of, agricultural co-operatives, direct loans to farmers and relief funds in war zones. In October 1940, the Farmers Bank of China took over all the lending operations of the Agricultural Credit Administration. The Central Bank of China financed military and civilian storage of food supplies and undertook purchase and sale operations for the maintenance of price stability.[4]

It is evident that through the expansion both of direct advances to the Government and of loans to official organizations, the operations of the central banking group were increasingly directed to the middle and long term financing of public, rather than private, activities. The reorganization of the National Treasury in 1941, which provided for centralization of the collection and disbursement of public funds, tended to strengthen the position of the Central Bank of China as the chief fiscal agent of the National Government.

Monetary Policy. Under the impact of the war and the impulse of credit expansion from the banks of issue, the circulation of legal tender notes expanded uninterruptedly. Monetary inflation did not assume any dangerous characteristics during the first two years of the war, but prices started on a runaway trend around the middle of 1940—at a time when severe distress in the domestic food supply and transportation difficulties conspired with monetary expansion to make prices skyrocket. Price levels and their rate of increase varied to a great extent from one area to another and the discrepancies between the price increases of different categories of commodities were extremely large.

Notes in circulation of the four banks increased at a monthly rate of about 3 per cent during 1937 and about 2 per cent during 1938. During the second half of 1937, prices rose at a

[4] Lin Yi-chien, "Chinese Government Banks in Wartime," *The Central Bank of China Bulletin,* Spring 1940, pp. 20 and 23; *China After Five Years of War,* China Information Committee, New York, 1942, p. 122.

TABLE 33

NOTE CIRCULATION, EXCHANGE RATES AND PRICES

1937–1941

	Central Bank of China	Bank of China	Bank of Communications	Farmers Bank of China	Total	Exchange rate $ per CN$100	Wholesale Prices Shanghai	Wholesale Prices Chungking
1937			*(in millions of national yuan)*					
June.....	375.8	509.9	313.5	208.0	1,407.2	29.653	100	100
December	430.6	606.5	371.2	230.8	1,639.1	29.468	112	105
1938								
June.....	489.7	653.2	321.9	262.2	1,727.0	18.835	116	130
December	..	..	..	..	2,000.0(?)	16.110	132	165
1939								
June.....	1,048.9	703.6	548.4	326.0	2,626.9	13.434	154	212
December	1,347.0	772.0	597.4	365.4	3,081.8	7.487	294	331
1940								
June.....	1,623.4	1,100.2	727.6	511.0	3,962.2	5.760	418	531
December	..	1,562.1	..	..	6,500.0(?)	5.690	484	1,211
1941								
June.....	..	..	..	..	10,000.0(?)	5.336	705	1,692
December	..	..	..	..	15,000.0(?)	5.690	1,150(?)	2.750(?)

Source: Note circulation: *Currency Reserve Board Reports* (for December 1940, *Annual Report of the Bank of China*.

Exchange rate: New York, *Federal Reserve Bulletin* (for December 1941, official rate of the Stabilization Board of China).

Wholesale prices: Shanghai—index prepared by the National Tariff Commission, Ministry of Finance.

Chungking—index prepared by the Chungking Office of the Department of Reconstruction, Szechuan Provincial Government.

rate of 2 per cent per month in Shanghai, which was the center of the zone especially affected by the hostilities; prices in the interior advanced slightly. During 1938, as an immediate consequence of the shift in hostilities from the lower to the upper Yangtze-kiang, prices were relatively stable in Shanghai, but they assumed a definite upward trend in the interior. By the end of 1938, the area of hostilities had become more or less stabilized, and prices began to move predominantly under the influence of monetary and supply factors. Currency in circulation during 1939 increased by CN$1,000 million, at a rate of 4.5 per cent per month. Prices in Chungking and Shanghai stepped upward at an average rate of 8 to 10 per cent per month; as a result of the relative isolation from abroad, together with good crops, the advance in prices in the interior was held down, as contrasted with Shanghai, where depreciation of the exchanges and a considerable inflow of floating funds created an industrial and real estate boom.

This situation underwent a fundamental change during 1940. Notes in circulation of the four banks rose by CN$1,000 million, at a monthly average rate of 5 per cent, during the first half of the year, and by an estimated CN$2,500 million, at a monthly average rate of 10 per cent, in the second half. During 1941, the expansion probably totaled CN$8,500 million, at a monthly average rate of about 11 per cent. Beginning in the spring of 1940, prices in free China shot up rapidly, and, by the latter part of 1941, they had reached an average of twenty-seven times the pre-war level; in Shanghai, on the contrary, prices continued to show a rather regular and slower uptrend (around 9.5 per cent per month).

Two significant conclusions may be derived from this analysis. First, by 1940 monetary inflation in China had reached an advanced stage, with prices rising at a faster rate than the supply of paper money. However, the rise in prices could not be explained on monetary grounds only—for high prices were basically the result of scarcity, which reflected conditions of insufficient production, hoarding and inadequate transportation facilities. The second conclusion is that the depreciation of the domestic purchasing power of the yuan had become far greater than the depreciation of its foreign exchange value. The explanation is that the domestic purchasing power was dependent upon the ratio between domestic supplies plus imports on available routes, on the one hand, and expanding military plus civilian demand on the other, while the foreign exchange value was determined by the supply of exchange in the hands of the Government and banks, in relation to the demand for foreign exchange, under special conditions of restrictive control.

Foreign Exchange Control before July 26, 1941. At the outbreak of hostilities in northern China, the Central Bank of China announced that it was prepared to maintain the currency at the rates prevailing at that time. With this purpose in view, the bank arranged for the sale of up to $50 million in national yuan to the United States Stabilization Fund, Chinese gold earmarked in New York being pledged as security for the eventual repurchase of these yuan.

There was practically no control over foreign exchange transactions during the first eight months of the war. Although this policy helped to maintain confidence in the national currency

and prevented serious disturbances, nevertheless a considerable amount of capital took flight into foreign currencies. In fact, the need for foreign exchange control had become evident at the very outset of the war, but no effective enforcement could be achieved in the case of foreign banks and extraterritorial areas. Under such conditions, Chinese bankers insisted that Government authorities should consult foreign bankers about measures for co-operation in the maintenance of the exchange rate of the national yuan. It would not be incorrect, therefore, to regard the measures finally adopted on March 14, 1938, as a compromise—the inadequacy of which became apparent soon after they were put into effect.

The enactment of foreign exchange regulations was precipitated by the opening, under Japanese sponsorship, of the Federal Reserve Bank of China at Peiping. The new institution proceeded to withdraw national yuan notes from circulation in northern China and to redeem them in foreign exchange at Shanghai. Evidently, valuable foreign exchange was diverted by this process from the four Government banks to the new institution, with repercussions not only of a monetary, but also of a political character. This was the first battle of what later became popularly known as the "currency war." As a countermeasure, the Government banks abandoned their policy of unlimited sale and purchase of foreign exchange at the official rates, and the Ministry of Finance issued the following regulations on March 13, 1938:

(a) Sales of foreign exchange shall be centralized through the Central Bank of China at the seat of the Government. For convenience, the Central Bank of China will establish a forwarding office in Hongkong.
(b) Banks desiring to cover any legitimate demand for foreign exchange on the part of their customers in excess of amounts obtained from the banks' purchases of bills of exchange, inward remittances and other ordinary market operations, may apply to the head office of the Central Bank of China or through its forwarding office in Hongkong.
(c) Applications shall be made before 10 o'clock every Thursday morning. After consideration of applications, a reply shall be communicated to each applicant by 10 o'clock the following morning. On holidays, applications and/or replies will be made on the next business day. Foreign currencies provided in response to applications will be delivered on the day on which the reply is communicated.
(d) After consideration of applications, the Central Bank of China shall furnish foreign exchange at the existing level of rates (1s. 2.250d. or $0.2925 per yuan). Banks to which foreign exchange has been pro-

vided by the Central Bank of China may be requested by the latter to furnish a statement of the disposition of such exchange.

Later measures included a stipulation that allotments of exchange would be made on the merit of each individual case instead of on the strength of applications by the banks. The banks were therefore required to submit certificates of import exchange needs, specifying the nature, quantity and value of the commodities imported, and designating the place of production and purchase. The banks were also asked to deposit sufficient yuan cash with the Central Bank of China to cover their demands for foreign exchange, in order to prevent excessive requests and to discourage speculation. By these measures, the Central Bank of China planned to eliminate the importation of luxuries and to regulate the importation of necessities according to the total of civilian and military requirements.

Since the regulations were not very rigid, the amount of foreign exchange granted depended largely upon the attitude of the financial authorities. During the first few months, the Central Bank of China adopted a very generous policy. The total amount of sterling and dollar exchange granted in the first month was estimated at £2.1 million, or about CN$35 million; this was over 30 per cent of the amount requested. By early June the percentage of allotments had dwindled to a little over 10 per cent; in September it decreased to 2 per cent; and later to below 1 per cent (see table 34, page 274). In the opinion of a Chinese author,

"if the National Government had exercised complete jurisdiction over its own territory and therefore over all the banks in China, or if the foreign banks had voluntarily co-operated with the Government in controlling the exchanges, these regulations might have been sufficient to attain the Government's objective of substantially limiting the demand for foreign exchange and thus maintaining the official rate as the prevailing rate and preventing the flight of capital."

Thus, given the National Government's inability to enforce exchange control in the major financial centers and the existence of powerful foreign banks as the principal exchange agencies, the dominance of a "free," in lieu of the "official," exchange rate became inevitable.

After August 1938, the four Government banks maintained two rates for the yuan, the "official" rate (1s. 2.500d. or

TABLE 34

FOREIGN EXCHANGE APPLICATIONS AND AUTHORIZED ALLOTMENTS UNDER EXCHANGE RATIONING SYSTEM

March–June 1938

1938	*Estimated amount of exchange applied for*	*Estimated amount of exchange granted*	*Percentage of applications granted*
Mar. 17	£ 900,000	£450,000	50.0
" 24	1,494,500	465,500	31.1
" 31	1,544,500	428,500	27.7
Apr. 7	1,400,000	429,000	30.0
" 14	1,800,000	350,000	19.4
" 21	1,000,000	350,000	35.0
" 28		220,000	
May 5	1,000,000	260,000	26.0
" 12	1,000,000	235,000	23.5
" 19		225,000	
June 2		185,000	
" 9		145,000	
" 16	1,100,000	95,000	8.6
" 23	1,375,000	71,000	5.1
" 30	1,400,000	82,000	5.8
July 7		60,000	
" 14	1,150,000	55,000	4.7
" 21		72,000	
" 28	1,500,000	53,000	3.5
Aug. 4		30,000	
" 11	800,000	53,000	6.6
" 18	900,000	38,000	4.2
" 25	880,000	47,000	5.3
Sept. 1	800,000	40,000	5.0
" 8		31,000	
" 15		27,000	
" 22		17,000	
" 29		8,000	
Oct. 6	880,000	11,200	1.2
" 13		..	
" 20		10,000	
" 27		..	
Nov. 3		..	
" 10		..	
" 17		6,000	
" 24		5,000	
Dec. 1		5,000	

After December 1, allotments dwindled to practically nothing.

Source: The Financial Review.

$0.30 per yuan) and the "free" market rate; a third rate, the "trading" rate, was adopted in July 1939. The maintenance of legal quotations ("official" and "trading" rates) involved comparatively little strain, since the amount of foreign exchange sold became very small after September 1938. The support of the free market rate, however, involved great strain. The extent of the sacrifice in such transactions can be gauged from the fact that, when the rate was seriously threatened after the fall of Hankow and Canton in October 1938, the Government banks sold foreign exchange to the extent of nearly £15 million (about CN$360 million) to prevent a fall in the yuan. Thereupon, foreign credits from the U.S.S.R., the United States and Great Britain began to come in, and although most of them were commercial in form, they contributed indirectly to replenishing the foreign exchange resources of the Central Bank of China. In particular, the British Stabilization Loan of March 1939 provided the foreign exchange needed for the management of the national yuan in the open exchange market of Shanghai.

The system of exchange rationing—designed to limit the outlay of foreign exchange—was accompanied by measures destined to concentrate foreign exchange inpayments in the hands of the Bank of China and the Bank of Communications. A Government agency, the Foreign Trade Commission, was set up in October 1937 with an initial fund of CN$20 million provided by the four Government banks; among its many functions, the Commission was entrusted with the task of providing financial facilities for the export trade and was placed in charge of the export of a list of goods under Government monopoly.[5] The activities of the Commission were administrative in character: the actual conduct of the business of trading in Government-controlled products was placed in the hands of three subsidiary corporations, and the operations connected with export trade finance and foreign exchange control were placed in the hands of the Bank of China and the Bank of Communications. The Central Trust of China was entrusted with war risk insurance of export goods and had temporary charge of the export of bristles, tung oil and other products until January 1940.

The Regulations Governing the Export Trade and Control

[5] The list included tung oil, tea, bristles, wool, hog casings, raw silk, hides and skins and other products.

of Foreign Exchange—issued on April 22, 1938—provided that, prior to the shipment of goods, the exporters should secure an exchange certificate from the Bank of China or the Bank of Communications; this certificate could be obtained only by agreeing to sell to the bank the foreign exchange credit arising from the transaction. After the goods were sold abroad, the exporters were asked to surrender to the bank 90 per cent of the foreign exchange obtained, for which the bank was required to pay the equivalent in national yuan according to the official rate (1s. 2.250d. or $0.2925 per yuan); the remaining 10 per cent was left to the exporter for the payment of expenses incurred in foreign currency. In June 1939, because of the depreciation of the foreign exchange value of the national yuan, the Ministry of Finance decided to drop the system of paying exporters according to the official rate and introduced the "trading" rate, which was consistently less favorable to exporters than the Shanghai free market rate, but more favorable than the official quotation. For instance, on July 1, 1939, the trading rate was fixed by the two banks at 7d. or $0.136; it was reduced to 4d. in August 1940. The substantial difference between the bank rate and the free market rate greatly encouraged evasion and further impeded the enforcement of the law.

These measures of foreign exchange control were implemented by a series of regulations on gold and silver, issued during 1939. The four Government banks were entrusted with the monopoly of all newly mined gold and gold materials and articles held for commercial purposes, as well as with the collection and purchase of gold and silver from the general public. The regulations provided that the price was to be fixed locally by the offices of the Central Bank of China or one of the other Government banks, after consultation with the Silversmith Guild.

Foreign Exchange Control after July 26, 1941. The difficulties involved in the enforcement of foreign exchange control were eventually overcome through the co-operation of the United States and Great Britain. The "freezing" of Chinese assets on July 26, 1941, by the two largest currency areas of the world made it possible to apply, through the American and British licensing systems, restrictions on yuan-dollar and yuan-sterling transactions and to achieve exchange rate stabilization.

In this international monetary set-up, the National Government of China and the four Government banks were granted the status of "generally licensed nationals." The term "generally licensed national" as applied to the "National Government of the Republic of China" was defined in the United States regulations as meaning that "such Government may be regarded as though China were not a blocked country, and all persons to the extent that they are acting for or on behalf of such Government may be regarded as generally licensed nationals." General Licenses Nos. 60 and 61, issued by the United States Treasury on July 26, 1941, specifically authorized any transaction engaged in by the Central Bank of China, the Bank of China, the Bank of Communications and the Farmers Bank of China, for their own account or "pursuant to the order of or for the account of any person within China" and "any payment or transfer of credit from any blocked account in which any national of China has an interest" to an account in the name of the Central Bank of China. Similar instructions were issued by British and Dutch monetary authorities.

In turn, the Central Bank of China designated the Bank of China in Singapore, Batavia, Rangoon, Calcutta, London, New York, Hongkong and Macao; the Bank of Communications in Manila[6] and Saigon, and the Bank of Canton in Bangkok as "agent banks" authorized to accept overseas remittances to be credited to the account of the Stabilization Board of China with the Central Bank of China. These measures were basically designed to direct into official channels all inpayments of foreign exchange from private and non-commercial sources. They effectively implemented the administrative rules of the Stabilization Board, which provided for a compulsory concentration of dollar and sterling trade inpayments in the hands of the "appointed" banks and a control over the release of dollars and pounds for private account.

The National Government, having gained positive co-operation from the United States and Great Britain, proceeded to reorganize its own foreign exchange control system. An Exchange Control Commission was set up in September 1941; it was presided over by the Minister of Finance, Dr. H. H. Kung,

[6] Operations in Manila were conducted through a subsidiary institution, the Philippine Bank of Communications, opened in the summer of 1939 with a capital of 2 million pesos.

and composed of representatives of the Ministry of Finance, the Joint Administration of the four Government banks and the Central Bank of China. The commission was vested with authority and power to deal with matters relating to:

(a) The study and formulation of the policy of exchange control;
(b) The examination and approval of applications for the purchase of foreign exchange;
(c) The control over compulsory sales of foreign exchange derived from exports;
(d) The supervision and direction of the remittances of the overseas Chinese;
(e) The disposition of the foreign exchange assets frozen in foreign countries;
(f) The distribution and utilization of foreign loans and credits;
(g) The planning and supervision of the collection of gold and silver;
(h) Investigation and research in problems of exchange control.

A certain amount of overlapping was bound to exist between the Commission and the Stabilization Board. However, the former could exercise its authority only over the National Government's foreign exchange transactions and the operations of the Chinese banks in, or with, free China, while the latter was in a position to enforce foreign exchange restrictions over Chinese banks in foreign concessions and abroad and over foreign banks' transactions with both free and occupied China. Therefore, prior to December 7, 1941 the two agencies complemented each other through co-ordination of policy by the three Governments interested in the support of the national yuan.

The application of this international foreign exchange control brought the yuan free market to an end, since all yuan-dollar and yuan-sterling bank transactions could be effected only through official channels and were subjected to general and special licenses. However, this gave rise to a "black" market, in which a certain amount of dollar and sterling checks and frozen credits were exchanged for yuan, until more positive co-operation of foreign banks and the amendment of foreign licenses restricted it to dealings in dollar and pound bank notes. As the supply of foreign bank notes was limited, a sharp depreciation of the value of the national yuan occurred in the black market; the rate on the dollar bank note fell as low as $0.025 per CN$1 in the middle of November and recovered slightly during the first week of December 1941. Needless to

say, changes in the bank note rates were of no consequence to the international position of the national yuan.

The Exchange Control Commission was set up as a policy-making and supervisory agency in the international money market; its functions were similar to those of the Joint Administration of the four Government banks in the domestic money market—the role of executive institution was officially left in the hands of the four Government banks. In fact, administrative control and operations in the international money market were restricted to three Government banks, the Central Bank of China, the Bank of China and the Bank of Communications, with the first institution playing the leading role on the Commission and the second the leading role in the market. These banks contributed to the Yuan Stabilization Fund the $20 million agreed upon by the four Government banks, supplementing the foreign credits obtained from the United States ($50 million) and Great Britain (£5 million).

Monetary Reserves. It is impossible to estimate precisely either the amount of foreign exchange reserves behind the national yuan and of the other foreign exchange resources of the Government banks. In 1937-39, in order to support the currency in the presence of a large flight of capital, the Currency Reserve Board (to which the monetary reserves had been turned over by the banks in November 1935) liquidated the remainder of its silver and gold reserves, estimated at $200 million; its foreign exchange reserves, probably depleted during 1939, possibly increased slightly during 1940 and 1941 through the repatriation of private funds from abroad. It may be estimated that foreign exchange reserves owned by the Government banks and held behind the national yuan at the close of 1941 amounted to less than $100 million—about CN$1,500 million at the current rate of exchange—which represented a reserve of 10 per cent or less of the total national yuan note issue.

Aside from these monetary reserves and the $50 million held by the Yuan Stabilization Fund, on December 31, 1941 China had small balances available from various foreign credits; namely, $27.9 million from the credits granted by the Export-Import Bank of Washington and undisclosed balances of British and Russian commercial credits. However, the restrictions placed upon these credits limited their actual use to specific

purposes and made them unavailable for general monetary stabilization.

In March 1942, with a view to strengthening the "currency, banking and economic system of China," the United States made available to the National Government an unrestricted credit of $500 million, and the British Government announced the extension of a £50 million loan to China. In addition, Chinese private funds held in the sterling and dollar areas at the beginning of 1941 were believed to total some $300 million to $500 million,[7] after July 1941, the freezing regulations caused a certain amount of repatriation and thus brought foreign exchange to the Central Bank of China.

In brief, despite the exhaustion of the resources in precious metals, the National Government usually had on hand amounts of foreign credits exceeding its actual requirements for foreign exchange, which were determined chiefly by the availability of routes for the importation of goods into free China.

The Reorganization of the Central Banking Group. Ever since the preparation of the project for the establishment of the Central Reserve Bank of China, in 1935, the reorganization of the four Government banks—with a view to making the Central Bank of China the sole central bank, the Bank of China the official exchange bank, the Bank of Communications the industrial financing institution and the Farmers Bank of China the agricultural and developmental agency—continued to be regarded as the ultimate aim of the National Government central banking policy. At the beginning of June 1942, the Joint Administration of the four Government banks took an important step in this direction, by deciding that:

(a) The Central Bank of China is to be the sole bank of issue and fiscal agent of the National Government, entrusted with supervision and control over the domestic money market and the foreign exchange assets of the other banks.
(b) The Bank of China is to be placed in charge of all foreign trade and foreign exchange business, while continuing to receive savings deposits, to issue savings certificates and to act in trustee capacity.
(c) The Bank of Communications is to handle the financing of mining, industrial enterprises and transportation.
(d) The Farmers Bank of China is to confine itself to rural credit, taking over the Bank of China's agricultural operations.

No decision was made with regard to the large interests in

[7] *Finance and Commerce,* February 12, 1941.

industry and commerce held by the Bank of China; it was understood, however, that the bank would not be forced to liquidate them and would be able to obtain advances, when necessary, from the Central Bank of China against industrial and commercial collateral. Moreover, the National Government undertook to enlarge its participation in the Bank of China, the Bank of Communications and the Farmers Bank of China, by increasing each bank's capital to CN$60 million.

The reorganization emphasized the increased powers and authority of the Central Bank of China. It was not clear how far the proposed specialization of functions would be carried and how the contemplated division of labor would work out in practice. However, the unification and concentration of note issue was effected on July 1, 1942.

As of that date, the Bank of China, the Bank of Communications and the Farmers Bank of China were required to transfer to the Central Bank of China the cash and securities reserves held against their notes in circulation; in turn, the Central Bank of China assumed the obligation to pay interest on these reserves for a period of three years and to provide rediscount facilities at rates of 2 to 4 per cent lower than the interest charged by the banks on discounts and advances to customers. The notes issued by the three banks were allowed to remain in circulation—evidently as a direct obligation of the Central Bank of China, the sole authorized bank of issue of the National Government.

The concentration and unification of note issue came as a move directed toward the establishment of a centralized control over the currency, at a moment when its expansion had reached a most critical inflationary stage. Although no information was disclosed, it is safe to estimate that during the course of the preceding year (July 1941-June 1942) the note circulation of the four Government banks had more than doubled, while prices had advanced even more rapidly, reaching the alarming average of approximately 50 times the pre-war level. However, other economic and political considerations probably had a bearing upon the action of the Joint Administration. During the spring of 1942, the "currency war" between the four Government banks and the Japanese-dominated banks of issue entered into a new active phase, as the Central Reserve Bank of China at Nanking, proceeded to exchange Central Reserve

currency for the national yuan notes in circulation in Shanghai and outlying districts. This resulted in a back flow of national yuan notes from occupied to free China, both on account of bona fide holders, who wished to retain their funds in the currency of the National Government, and of Japanese and Japanese-dominated interests, which used the national yuan notes withdrawn from circulation in the occupied area for purchase of commodities (particularly raw cotton) and for other payments in free China. It seems probable, therefore, that the National Government carried out the reorganization of the central banking institutions and the centralization of the note issue not only with a long view to post-war reconstruction, but also, and perhaps primarily, for the purpose of dealing immediately with economic and political problems arising from the war situation.

THE LOCAL OFFICIAL BANKING GROUP

At the opening of the Sino-Japanese war, the National Government was pursuing a policy of reorganizing the provincial and municipal banks. The National Government aimed chiefly at the elimination of local currency issues and the introduction of the national yuan; secondarily, it endeavored to re-adjust the functions of these banking institutions according to the requirements of local financial markets. In the middle of 1937, the reorganization of the official banks in the southern provinces (Kwangtung, Kwangsi and Yunnan) was under way.

Reorganization of Local Currencies. The management of the Kwangtung Provincial Bank, appointed by the National Government in 1936, was able to create confidence in the institution, accumulate foreign exchange assets and show substantial profits from business operations. Consequently, the national currency met with considerable resistance in Kwangtung, and for some time (in 1937-38) the provincial currency was traded at a premium over the national yuan; a legal parity of local yuan 1.44 per national yuan was fixed in 1937. In 1938, the Kwangtung Provincial Bank took over the business of two Canton institutions, the Silk Bank and the Industrial Bank of Kwangtung, and expanded its note circulation, which probably rose to above 300 million local yuan—50 millions in new notes being issued in August 1938.

The expansion of warfare and the occupation of Canton by

Japanese troops in the autumn of 1938 disrupted the entire process of financial reorganization. The Kwangtung Provincial Bank moved its headquarters into free territory, where it expanded its network of branches (which reportedly totaled 120 in 1941) and its ordinary banking business; the bank granted large amounts of farm loans, participated in the national savings campaign and facilitated overseas remittance from Hongkong, French Indo-China and Malaya. It maintained its note issue in the free area, along with the circulation of the national yuan; stability in the domestic exchange between provincial and national currencies was reportedly achieved by the end of 1939.

Similarly, in Kwangsi and Yunnan provinces the local bank notes remained in circulation. In the provinces of Sikong, Kweichow and Kansu, newly established provincial banks were authorized in 1940 to issue notes and were entrusted with local currency stabilization. However, outlays by the National Government for purchases, services and credits and the establishment of Government bank offices brought about an uninterrupted flow of national yuan notes to outlying regions, thus creating a situation favorable to a wider acceptance of the national currency.

The Ministry of Finance generally followed the practice of permitting the provincial and local banks to issue a limited number of one-yuan and subsidiary notes. This practice was eventually regulated by an ordinance issued on May 11, 1940, which provided that (a) circulation of the notes issued by provincial and local banks should be limited to the area of their business activities, and (b) the monetary reserve should consist of 40 per cent in gold, silver and legal tender (national yuan) notes; and 60 per cent in warehouse receipts for marketable commodities, in Government, provincial and municipal bonds and in deposits with the Central Bank of China, the Bank of China, the Bank of Communications and the Central Trust of China (subsidiary of the Central Bank of China). Moreover, the Central Trust of China was charged with the printing of provincial and local notes, and the Currency Reserve Board was given the "supervision of provincial or local banks in regard to the issue of bank notes as well as the deposit and custody of note reserves";[8] both measures were taken to

[8] *The Central Bank of China Bulletin,* Winter 1940, pp. 536-7.

prevent uncontrolled issues of paper money. The permission to issue notes was officially granted to provincial and local banks on the ground that local currency was intended to "restrict the issue of legal tender and prevent the Japanese from absorbing the Chinese national currency."[9] At the end of 1940, it was estimated that outstanding provincial bank notes amounted to about 500 million local yuan, in addition to some 50 million local yuan put into circulation by the Northwestern Border Government.[10]

Operations of Provincial and Municipal Banks. With regard to official functions, it was the National government's view that provincial and municipal banks were to act as provincial and municipal treasuries; after June 1941 the provincial banks became agents of the National Treasury in their respective provinces. In the performance of their banking operations, the banks were to be used mainly as financial agencies for reconstruction purposes, the maintenance of the rural economy, the promotion of local industries, the development of public utilities and communications and the expansion of social enterprises. Clearly, such operations involved great risks, therefore, the usual method of financing was indirect—i.e., the banks provided funds for official and semi-official agencies which were in charge of actual disbursement in the various economic projects undertaken by public initiative.

After 1938, the activities of these agencies in the exploitation of local resources were gradually centralized in provincial development corporations, set up with capital subscribed by the provincial Government, the National Government, three of the Government banks (Bank of China, Bank of Communications, and Farmers Bank of China) and private businessmen and industrialists. The basic functions attributed to these corporations was the long term planning of industrial development within the limits of the respective provinces; purely administrative matters were left in the hands of existing agencies, and current financial operations continued to be handled by provincial and municipal, as well as by other banks.

In the agricultural field, provincial and municipal banks made advances to the *hsien* (district) authorities; to rural co-

[9] *The Central Bank of China Bulletin,* Summer 1940, p. 162.
[10] *Finance and Commerce,* January 15, 1941.

operatives (usually on the security of commodities stored in warehouses) for the purchase of seed, fertilizers and farming implements, and to farmers, in the form of long term mortgage loans. Particular attention was said to be paid to land reclamation, in order to expand the area of arable land and to make extensive and intensive cultivation possible.

In the commercial, industrial and communications fields, the provincial and municipal banks invested in and made loans to trading and manufacturing enterprises and public utilities owned or controlled by provincial and municipal agencies. They also financed road building and purchases of transportation equipment by public bureaus and companies, contributed capital and working funds to industrial co-operatives and granted current credit to private merchants and industrialists. Assistance to household crafts and small tradesmen was also furnished, usually through small loan bureaus set up in co-operation with public authorities. In May 1940, all provincial and municipal banks were instructed by the Ministry of Finance to extend small loans for the purpose of fostering the growth of small commercial and industrial enterprises; the regulations provided that loans should be divided into current loans and fixed loans, secured by personal and/or real guarantees and repaid in installments.

Some of the provincial banks (Fukien, Kwangtung, Kwangsi, Yunnan, etc.) spared no effort in building up foreign exchange assets, through the direct export of local products or through the collection of overseas remittances. Before 1941, this practice provided handsome returns, the internal value of these foreign assets increasing by the rate of depreciation of the national yuan.

As provincial and municipal banks devoted themselves mainly to the promotion of production by investing their capital resources and issuing bank notes, no great attention was paid (at least prior to 1939) to the work of absorbing savings from the people. The bulk of their deposits was in the form of current accounts, which represented the liquid funds of public authorities and public enterprises financed by the banks themselves. However, savings and trust operations were developed to some extent by most of the banks after 1939; funds thus collected were usually invested in Thrift and Reconstruction Savings Certificates of the National Government.

Local official banks, organized by *hsien* authorities, were regulated by the *Hsien* Bank Law of January 20, 1940. This law provided that these local banks should be registered with the Ministry of Finance. They were required to have a capital of not less than CN$50,000 subscribed by local authorities and the general public, and their activities were limited to the local administrative district. In addition to general banking activities, these banks were instructed to act as fiscal agents of local authorities, to participate in economic reconstruction and to promote co-operative enterprises.

THE ORDINARY BANKING GROUP

The deterioration of the political and military situation during the summer of 1937 led to withdrawals of deposits from Chinese banks and liquidation of investments. With the outbreak of hostilities at Shanghai on August 13, 1937, the National Government proclaimed a banking holiday. Meanwhile, upon the recommendation of the Shanghai Bankers Association, the Ministry of Finance issued emergency measures, which provided for (a) restrictions on withdrawals of deposits and (b) the adoption of *Wei-wah* checks as non-convertible credit instruments good for inter-bank settlements only. By these measures, the financial tension was greatly relieved, and on August 17 modern and native banks resumed business.

The Wei-wah System. In pre-war years, *Wei-wah* (or clearing) represented a favorite method of settlement among both native banks and modern banks. Any bank order or check, marked with a *Wei-wah* stamp, was recognized as acceptable paper for the purpose of making or collecting payment among banking institutions; such paper was honored by banks one day after the date of its maturity. The Banking Regulations, issued by the Ministry of Finance on August 15, 16, 20 and 31, 1937, provided that (a) cash withdrawals of current deposits from modern and native banks should be limited to 5 per cent of the outstanding credit balances and could not exceed CN$300 per week; (b) fixed deposits could not be withdrawn, but could be converted into current deposits on the maturity date; and (c) special arrangements could be made by banks for commercial and other essential cash requirements. Withdrawals in excess of these limits were permitted if made only

in the form of credit instruments good for inter-bank settlements (*Wei-wah* checks) and not in national yuan notes.

This meant that business transactions were carried out on a credit instead of a cash basis. In Shanghai, however, as in other money centers where most commercial transactions in normal times were settled through *Wei-wah*, the new system did not seriously disturb the customary procedure. New current deposits, made subsequent to August 16, 1937, were divided into cash accounts and *Wei-wah* accounts; cash accounts could be freely transferred, withdrawn and exchanged for foreign currencies, while *Wei-wah* accounts were restricted to inter-bank transfers and could not be converted into foreign currencies. The Joint Reserve Board of the Shanghai Bankers Association co-operated with the Joint Loan and Discount Committee of the four Government banks in making *Wei-wah* funds available to banks to the extent of more than CN$10 million; approximately half of this credit was repaid before the close of 1937.

These conditions gave rise to the establishment of a market in *Wei-wah* in relation to national currency notes; at first the discount rate was about 4 per mille, rising rapidly to over 60 per mille in November 1937. In January 1938, the Joint Reserve Board of the Shanghai Bankers Association started daily announcments of buying and selling rates for *Wei-wah*, thereby exercising some degree of influence in the market; the discount fluctuated around 50 per mille during the following months. In the course of twenty-two months, the major portion of funds locked up by the moratorium of August 1937 was liquidated, partly by gradual disbursements in cash and partly through application of *Wei-wah* deposits toward the refund or reduction of existing loan obligations; at the end of June 1939, the total volume of outstanding *Wei-wah* accounts amounted to only CN$22 million.

This decrease in the *Wei-wah* accounts, which was taking place under favorable conditions of banking liquidity, had the effect of restricting the amount of funds which were not convertible into foreign currencies. Therefore, on June 21, 1939, the Ministry of Finance issued a new order to Chinese bankers in Shanghai, to the effect that "the withdrawal of deposits—other than for meeting payrolls and official requirements—should be limited to CN$500 in cash per person per week."

Whereas the moratorium of August 1937 was proclaimed at the suggestion of Chinese bankers and aimed at protecting the banks against excessive withdrawals, the order of June 1939 was put into effect by the National Government for the purpose of preventing the general public from using cash balances in the field of foreign exchange. However, as the order came shortly after the suspension of official support of the national yuan exchange at Shanghai, it provoked intense nervousness. There was a rush for withdrawals within the maximum limits permitted by the order, and, as a result, an acute shortage of national yuan notes developed in the market. Consequently, the *Wei-wah* discount rate resumed its rise and reached the unprecedented level of 270 per mille on July 21, 1939.

Under such precarious conditions, the Joint Reserve Board of the Shanghai Bankers Association, in co-operation with the Joint Reserve Board of the Native Banks Clearing Association, decided upon two courses of action. First, the Board made arrangements to allow the banks to convert into cash, at a discount of 5 per cent and in twelve installments, the entire outstanding balance of *Wei-wah* accounts blocked in 1937. Beginning July 4 and ending September 19, 1939, CN$1.8 million of *Wei-wah* balances was retired each week by the Central Bank of China, the Bank of China and the Bank of Communications. Second, *Wei-wah* certificates (good for inter-bank settlements only) were issued by the Board to modern and native banks up to 70 per cent of the market value of collateral security consisting of real estate, commodities and other valuable assets. In order to promote general confidence in these certificates, the Board entrusted a special committee with monthly auditing of the assets deposited by the banks; this committee included representatives of the Chamber of Commerce, the four Government banks, the Foreign Exchange Bankers Association, the Native Banks Clearing Association and the Shanghai Bankers Association. The issue of these certificates was equivalent to a granting of *Wei-wah* credits by the Board and resulted in a mobilization of slow and illiquid assets (particularly real estate) held by the banks. The amount of assets deposited as security and certificates approved for issue expanded steadily until the middle of 1940, thereafter showing a monthly reduction.

This intervention of the Joint Reserve Board considerably

TABLE 35

WEI-WAH CERTIFICATES AND COLLATERAL SECURITY

(in thousands of national yuan)

	July 31, 1939	*July 31, 1940*	*July 31, 1941*	*Sept. 30, 1941*
A. Assets deposited as security				
1. Commodities	2,317	3,249	..	..
2. Stocks and debentures	4,248	9,986	6,198	5,136
3. Real estate	16,259	47,230	35,731	22,719
4. Legal tender notes	2,741	..	..	..
Total	25,565	60,465	41,929	27,855
B. *Wei-wah* certificates approved for issue				
1. Amount issued	8,824	23,922	13,306	7,179
2. Amount issuable	5,927	14,572	13,430	10,342
Total	14,751	38,494	26,736	17,521

Source: *Finance and Commerce.*

eased the *Wei-wah* market, and the discount rate initiated a declining trend, which was further influenced by the accumulation of idle cash in Shanghai. Beginning November 11, 1940, transactions in Government bonds were restricted to cash, and all *Wei-wah* credits and debits among dealers were converted into cash at a discount of 5 per mille. In the meantime, the accumulation of idle funds caused the Shanghai banks to lower interest rates on cash accounts, and this in turn helped to adjust the demand for and supply of cash and *Wei-wah* in the local money market. The exchange of *Wei-wah* and cash at par prevailed after June 1940, so that the practice of discounting *Wei-wah* paper died a natural death.

The Problem of Domestic Remittances. The efforts of the National Government to control bank funds in the Shanghai market must be viewed against the background of the general monetary situation of the country. Despite the occupation of the Yangtze region by Japanese forces, Shanghai continued to be the main supplier of industrial goods to the interior. Consequently, Shanghai's position in the domestic balance of payments was characterized by a net credit toward free China; i.e., the amount of trade remittances from the interior to Shanghai exceeded the amount of remittances from Shanghai to the interior. This basic situation was further aggravated by the flight of capital from the interior to the international zone of Shanghai. By the early part of 1938 this flow of floating funds

became a dominating factor in China's domestic monetary situation. While a considerable portion of these funds was eventually transferred abroad (probably CN$1.500 million, at current exchange rates), the money accumulated in the Shanghai market, by the summer or autumn of 1940, was estimated to total some CN$2,000 million or CN$3,000 million.

This flight of capital from the interior, which resulted in a plethora of funds in the speculative market of Shanghai, exercised a deflationary influence upon productive investments in free China. In 1938 the National Government imposed the first restrictions on bank, postal and telegraph remittances to Shanghai. These restrictions failed to halt the movement, and the bank premium for remittances from Chungking to Shanghai (i.e., the appreciation in value of funds in Shanghai as compared with funds in Chungking) averaged 330 per mille in 1938 and 540 per mille in 1939; this rise in the Shanghai exchange directly affected the price of goods imported into free China from the coastal port.

Toward the end of 1939, the Ministry of Finance instructed the Government banks to form a Domestic Remittances Control Commission, with its head office in Chungking and branches in leading cities, and provided that domestic remittances from the interior to the occupied areas should be restricted to purchases of essential products and payments for certain special services. These remittances, which were charged a fee of 400 per mille, had to be approved by the Committee and paid at Shanghai in *Wei-wah* accounts, instead of cash. Conversely, as an encouragement for remittances from Shanghai to free China, the Government banks charged no commission and agreed to accept *Wei-wah* checks for full cash payment at destination.

These official regulations apparently failed to bring about any significant results. After the middle of 1940, however, the movement of capital was directly affected by the growing difficulties in finding profitable channels for idle funds in Shanghai. The accumulation of idle domestic funds, the repatriation of foreign balances and the calm prevailing in various speculative markets (especially in the foreign exchange market) late in 1940 and in 1941 led to an accumulation of excess reserves among Shanghai banks.

This opened a period of easy money, characterized by the

fall of the call loan and acceptance rates of the Joint Reserve Board from above 30 per cent in the spring of 1940 to around 8 per cent in the summer of 1941. Consequently, the modern banks took steps to reduce interest rates on current deposits from 3 to 2 per cent on October 1, 1940 and to 1½ per cent on April 1, 1941; in addition, most commercial banks suspended payment of interest on deposits above certain maximum balances and introduced charges on checking accounts. The decline of the rates in the Shanghai money market was accompanied by increases in the rates paid on deposits by banks in free China; at the end of 1940, the minimum rates were set at 5 per cent for current savings deposits (withdrawable by passbook) and 10 per cent on fixed-term savings accounts. Furthermore, the National Government, through the Ministries of Finance and Economic Affairs, gave great publicity to the opportunities for investments in free China and put strong pressure upon Chinese capitalists to participate in the development of China's hinterland. Last, but not least, China's military resistance and the political and financial support of the United States and Great Britain represented encouraging prospects for private investors in free China.

These factors reversed the previous trend and contributed to some net return of funds from Shanghai to free China during the years 1940 and 1941. The premium for domestic remittances from Chungking to Shanghai fluctuated around 250 per mille until the summer of 1941 and fell to 50 per mille or less in the following autumn. At the beginning of 1941 a new Shanghai modern bank—the Ho Cheng Bank—specialized in domestic remittances, with buying and selling rates quoted daily for various centers of free China, and thus played an important part in fostering the movement of capital to the interior.

As the flight of capital to Shanghai ceased and a certain degree of stability was achieved in the remittance market, the National Government was faced with the problem of directing bank credit in free China to productive purposes and preventing speculative uses. In the spring of 1940 it was estimated that floating funds amounted to CN$300 million in Chungking alone and totaled some CN$4,000 million in the interior. With the closing of the major channels of transportation, the movement of funds from Shanghai to free China could not be made

in equipment and materials, but could only take the form of remittances, which had the same effect as an expansion of central bank credit. In order to restrict this inflationary pressure, the Ministry of Finance issued regulations on August 7, 1940, designed to limit the flow of bank credit into speculative activities and to divert it toward the financing of productive enterprises and the distribution of commodities.

These regulations (which were revised in December 1941) provided that all modern and native banks should keep reserves, equivalent to 20 per cent of their total deposits, in one of the local offices of the four Government banks, at a reasonable rate of interest. Banks were authorized to make loans only for productive purposes, to facilitate the movement of goods from the coast into the interior or other scattered places and to strictly legitimate business firms—this requirement to be enforced by periodic examinations of the accounts of banks, of their go-downs, and of the books of firms receiving bank loans, as well as by the requirement that, in general, loans be made only to bona fide members of merchant guilds responsible to the Government for the character of their membership. The regulations prohibited the creation by the banks of subsidiary cash shops and the use of bank money by the employees for ostensibly private purposes, and restricted the direct participation of the banks in business enterprises for their own account or on behalf of their customers. Provision was also made for the limitation in term and amount of loans secured on warehouse receipts, as well as the extension of unsecured loans, both of which were frequently used for speculative purposes. The regulations further prohibited the creation of new banking companies or firms of any kind, limited bank dividends and bonuses to employees and provided for the introduction of a unified bank accounting system.

It is difficult to appraise the efficacy of these measures, the application of which was not initiated until the beginning of 1942. The trend of the call money (half-monthly) rate in the Chungking market continued to lag considerably behind the rise in prices and the expansion of speculation, thus reflecting the steady accumulation of floating funds in search of investment. In 1938 and 1939, the rate averaged 11.5 per cent and 12.2 per cent per annum, respectively; it rose to 21.5 per cent during 1940 and to 33.6 per cent during 1941. Although after-

ward the published rate remained unchanged, the market interest was frequently around 40 to 50 per cent per annum in Chungking and at least twice as high in other cities and towns. As prices in free China after 1940 rose at a rate of perhaps 150-200 per cent per annum, the borrowers of call money, most of whom seemed to use the credit for the purchase and hoarding of commodities, were not hampered by the rise in interest rates and could benefit from the depreciation of the purchasing power of money.

Resources and Operations of the Ordinary Banking Group. For obvious reasons, banking was subject, as were all other business activities, to most disturbing and obstructive influences. Some of the leading ordinary banks suspended the publication of their annual reports; hence any analysis of the general banking situation is more or less arbitrary.[11]

After considerable withdrawals of funds during the early stages of the Sino-Japanese hostilities, deposits of all banks tended to increase; but the new business consisted exclusively of current accounts. Between 1937 and 1939 current deposits in four of the largest ordinary banks (Shanghai Commercial and Savings Bank, National Commercial Bank, Chekiang Industrial Bank and China and South Sea Bank) increased from a total of CN$163 million to CN$1,192 million—an expansion of 610 per cent, while fixed deposits contracted from CN$120 million to CN$98 million; a similar trend was noticeable among four middle-sized institutions (Chinese Industrial Bank, Land Bank of China, Kwang Hwa Bank and Ming Foo Bank).

This inflation of current liabilities obliged the banks to increase their cash reserves and to readjust their investment policy. Under war conditions, losses in bank assets were unavoidable, but the modern banks were able to cover their losses out of hidden reserves, capital gains produced by price rises and current profits. While banking activities in commercial documentary credit and foreign trade financing contracted, there was expansion in other activities such as custodies, warehousing, real estate and trust business.[12]

[11] Lin Yi-chin, "Chinese Commercial Banks in Wartime," *Central Bank of China Bulletin,* Autumn 1941.

[12] Evidence of this could be found in the percentage distribution of the earning assets of the Shanghai Commercial and Savings Bank. During the course of the war (1936-39), this bank decreased its documentary bills, secured loans, and bills discounted and purchased from 68.5 to 49.5 per cent; increased

All of the ordinary banks operated in the foreign exchange market and most of them engaged in the financing of speculation and hoarding. The major part of the operations of many banks consisted of loans to cash shops, which used to re-loan the money on a 15-day basis for what could only be speculative purposes, the interest rates being so high that no legitimate business could expect to cover interest payments. Some banks apparently set up cash shops and operated them as subsidiary activities, while other banks permitted their employees to conduct cash shops with bank funds. Many banks financed commercial firms owned by their directors, on little or no security. In 1940 this gave rise to considerable concern with regard to the liquidity of the reserves of some banks and resulted in the issuance of the regulations of August 7, 1940 against financing of speculative activities by banks.

Although the exact scope of bank speculation in Government bonds remains open to conjecture (figures for such activities were never disclosed), there is no doubt that ordinary banks led the wartime revival of real estate, particularly in Shanghai. The expanding volume of financial transactions and the rising prices of securities and commodities were reflected in the monthly clearances through the Clearing House of the Shanghai Bankers Association, which rose from pre-war averages of between CN$250 million and CN$300 million to more than CN$300 million in 1939, more than CN$600 million in 1940 and more than CN$1,000 million in 1941.

On the other hand, there was a reduction in the participation of ordinary banks in rural reconstruction credit (especially in the form of co-operative financing) and loans for constructive enterprises; these activities had been taken over by the four Government banks and provincial and municipal institutions. It is difficult to evaluate precisely the effect, in this field, of the regulations of August 7, 1940, which provided for productive investment of bank credit. It is reported, however, that the return of floating funds from Shanghai to the interior during the course of 1940 and 1941 was accompanied by a limited resumption of investments in agriculture, mining,

its unsecured loans from 16.0 to 21.0 per cent, and expanded its security holdings and investments in real estate from 15.5 to 29.5 per cent.—Lin Yi-chin, *loc. cit.*, p. 357. A similar situation was evident in 1940 among twenty-six banks in free China.

industry and communications. A number of Shanghai ordinary banks (Shanghai Commercial and Savings Bank, China and South Sea Bank, Kincheng Banking Corporation, Sin Hua Trust and Savings Bank and National Commercial Bank) established branches in important centers of the southwestern provinces, including Szechuan, Yunnan, Kweichow and Kwangsi. In addition to these nationwide banks, there were in free China three important Szechuanese institutions, the Mei-fong Banking Corporation, the Szechuan Salt Bank and the Young Brothers Banking Corporation, and one ordinary bank in the province of Yunnan, the Sin-Kwa Bank.

The war also affected the monetary policy of the National Government with regard to the note issues of ordinary banks. After the monetary reform of 1935, ordinary banks proceeded gradually to withdraw their notes from circulation; at the outbreak of the Sino-Japanese hostilities, notes still outstanding were believed to amount to only CN$70 million (as compared with CN$187 million on November 3, 1935). In order to relieve the acute stringency of currency, the three Government banks (the Central Bank of China, the Bank of China and the Bank of Communications) reissued, in August 1937, some CN$30 million or more of the notes of seven or eight Shanghai ordinary banks and assumed full responsibility for the exchange at par of these notes with their own. Although most of this emergency issue was withdrawn before the end of 1937, it was estimated that some CN$80 million in notes of ordinary banks remained outstanding, and no apparent effort was made to reduce this circulation.[13] In the spring of 1938 the Ministry of Finance announced that the four Government banks were prepared to issue subsidiary notes through ordinary banks and other financial institutions, provided these were used for financing agricultural, industrial and mining undertakings. Toward the end of 1940 the Ministry of Finance went a step further by ordering the free circulation and acceptance at par of the notes of eight ordinary banks (Ningpo Commercial and Savings Bank, Agricultural and Industrial Bank of China, Bank of Agriculture and Commerce, Commercial Bank of China, National Industrial Bank of China, National Commercial Bank, Land Bank of China, China and South Sea Bank) in

[13] *Finance and Commerce,* September 22, December 15, 1937; April 27, August 17, 1938.

southern provinces. According to *Finance and Commerce* of January 15, 1941, the outstanding note issue of various ordinary banks totaled somewhat less than CN$200 million; the legal coverage for these notes consisted of 40 per cent legal tender (national yuan) notes and 60 per cent Government bonds and agricultural, industrial and commercial assets. However, this note issue had quite an insignificant bearing on the monetary situation of the country, as it represented only 3 per cent of the national yuan notes put into circulation by the four Government banks.

Speculative transactions, capital gains and various services aided in the maintenance of a high profit level; dividends distributed by Shanghai ordinary banks for the year 1940 ranged from 8 per cent to 20 per cent on paid-up capital.

Non-Banking Institutions. Little information has been made available on wartime banking developments of non-banking institutions. The two Government agencies—the Postal Remittances and Savings Bank and the Central Trust of China—were placed under the jurisdiction of the Joint Administration of the four Government banks. Both agencies specialized in the collection of savings through the sale of Thrift and Reconstruction Savings Certificates. The first institution acted directly and independently, while the latter operated directly and through the subsidiary Central Savings Society as well. The Postal Remittances and Savings Bank expanded its banking facilities in the western and southern sections of China. The Central Trust of China increased its insurance business; upon instructions of the Ministry of Finance it took charge of the underwriting of life insurance and land war insurance, which covered stored commodities, productive equipment, raw materials, buildings, building materials and transportation risks. The policies underwritten between the autumn of 1937 and the summer of 1940 were reported as totaling CN$865 million (CN$600 million on transportation risks and CN$265 million on other insurance), of which CN$335 million was outstanding at the end of June 1940.[14]

INTER-BANK RELATIONS AND CO-OPERATION

Important changes occurred during the course of the war in the market organization which had been built by modern banks during the five years preceding the outbreak of hostilities.

[14] *The Central Bank of China Bulletin,* Autumn 1941, p. 400.

With the transfer of the National Government from Nangking to Hankow and Chungking, the National Loan Sinking Fund Committee ceased to play any important role in the management of the public debt. Although the Ministry of Finance continued to remit regularly the sinking funds to the Committee and to inform it of any new issues, Government bonds were delivered directly to the head offices of the four Government banks.

After August 1937, the Clearing House of the Shanghai Bankers Association limited its daily sessions from two (at 1:00 and 3:30 p.m.) to only one (at 3 p.m.); however, the clearing procedure remained unchanged. Although the functions of clearing agent in settlements between modern and foreign banks were undertaken by the Hongkong and Shanghai Banking Corporation (beginning August 14, 1937), modern banks found it convenient to concentrate their debit and credit items in the Joint Reserve Board of the Shanghai Bankers Association (beginning December 1, 1939). Clearances between modern and native banks were also unified, as the Joint Reserve Board of the Native Banks Clearing Association joined the Shanghai Clearing House of the Shanghai Bankers Association. A Clearing House, with the majority of modern and native banks as members, was opened in Chungking on June 1, 1942; the clearing service was provided by the Central Bank of China.

Throughout the war, the Joint Reserve Board of the Shanghai Bankers Association continued to represent an important stabilizing element in the market, by lending short term funds in *Wei-wah* and cash and by mobilizing slow and illiquid assets held by the banks. With commercial credit greatly contracted and dealings in acceptance paper practically at a standstill, the Bankers Acceptance House of the Joint Reserve Board of the Shanghai Bankers Association suspended all activities as of July 1, 1941.[15]

In the investment field, no information was made available after 1936 with regard to the operations of the China Development Finance Corporation, an investment organization formed by modern banks. Nevertheless, the practice of forming banking syndicates for investment purposes continued to be

[15] The amount of bills accepted by the House declined from CN$11.0 million in 1937 to CN$5.2 million in 1940, while the properties deposited as security for acceptance contracted during the same period from CN$5.6 million to CN$2.1 million.—Chang Shan-pao, "The Shanghai Bankers Acceptance House," *The Central Bank of China Bulletin,* Summer 1941, pp. 195-7.

used extensively; these syndicates were led by the Bank of China and the other Government banks and included all the important ordinary banks. The participating institutions contributed funds at attractive interest rates, with the stipulation that the money was to be invested in free China. A similar syndicate was planned in 1940, with the object of transferring floating funds from the Shanghai market into fixed capital investment in free China.

Toward the end of 1940 a number of trust companies and banks of Shanghai (Chinese Industrial Bank, Sin Hua Trust and Savings Bank, Yeong Dah Bank, China Trust, The First Trust of China, International Trust, Shanghai Trust, South Eastern Trust, Chin An Trust, Ho Jang Trust, Seng Dah Trust and Tung Yih Trust) initiated the formation of a "Chinese Stock Promotion Committee," for the purpose of "promoting the flow of capital into large scale Chinese enterprises and facilitating the conversion and diversification of investments." While this committee was not a stock exchange and the responsibility for operations rested with the individual members, the business routine and the listing system were similar to those of the foreign stock exchange of Shanghai. Stocks admitted to trading numbered seventy-six, which included the shares of twenty-two banks.

The Agricultural Credit Administration, a joint institution of the Ministry of Economic Affairs and of the Government and private banks, was reorganized by a law of June 18, 1938. In addition to a fixed fund of CN$6 million, various participating banks undertook to subscribe a "joint capital" of CN$6 million and to provide such working capital as would be agreed upon at the beginning of each year. The rate of interest on the capital and other invested funds was limited to 8 per cent. The head office of the Administration was established at Chungking, and its field of activity was shifted from the coastal area to western China. The provinces of Szechuan, Sikong, Kwangsi, Kweichow, Yunnan and Shensi were designated as the Central Zone; and Kansu, Honan, Hunan, Kiangsi and Kwangtung as the Outer Zone. Permanent reconstruction, as well as emergency undertakings, was carried out in the Central Zone; as for the Outer Zone, though permanent construction was not ignored, greater emphasis was laid on emergency undertakings; territories beyond the Outer Zone received attention only in

emergency measures. At the end of 1941 it was reported that, of CN$499 million allotted through the Agricultural Credit Administration during 1941, the Central Zone received 62 per cent, the Outer Zone about 25 per cent, and the balance was distributed among nine provinces in war and occupied zones. Of the total loans, however, 93 per cent was for agricultural production and only seven per cent was for irrigation, agricultural improvements and land reclamation.

Originally the internal organization of the Administration consisted of two divisions. The Division of Agricultural Adjustment was entrusted with the purchase and sale of agricultural products on behalf of the National Government and with the improvement of farming methods, while the Division of Business was entrusted with the establishment and administration of granaries and other warehousing facilities and with the promotion of rural financing institutions and loans to farmers. The Division of Agricultural Adjustment was financed chiefly through the Joint Administration of the four Government banks; in October 1940, its lending operations were entirely transferred to the Farmers Bank of China. The capital funds of the Agricultural Credit Administration were to be used exclusively for the undertakings of the Business Division. In addition, the law provided that the Administration was to collaborate with participating banks, county banks, rural agricultural banks, agricultural co-operatives and farmers' pawnshops and to recommend that they "extend security loans on agricultural products, make re-mortgages on securities on hand and extend farm credit in designated amounts." On February 1, 1942, the organization of the Agricultural Credit Administration was absorbed by, and became an integral part of, the Commodity Control Bureau of the Ministry of Economic Affairs. This Bureau was entrusted with the control of commodity distribution and supervision over the use of commercial credit with a view to preventing the granting of it for hoarding purposes.

As the amount of funds at its disposal was limited and reserved for specific purposes only, the Agricultural Credit Administration actually operated as an agency of co-ordination and control of bank lending for agricultural development. However, ordinary banks being concentrated mainly in the occupied zone, the credit requirements were furnished almost

entirely by the four Government banks and provincial institutions; participation by ordinary banks was insignificant. Consequently, the Agricultural Credit Administration became closely connected with the Joint Administration of the four Government banks; this intimate relationship should be kept in mind in analyzing agricultural credit operations of both agencies.

THE MODERN BANKING SYSTEM OF FREE CHINA—CONCLUSION

The war created both the opportunity and the need for the development of financial centers in the interior. The basic changes which took place in the modern banking system between 1937 and 1941 were closely connected with the shifting of governmental activities from the coastal regions to the western and southern provinces. This wartime trend is briefly summarized in table 36, opposite.

Although it is not possible to make a detailed analysis of the distribution of bank assets and liabilities, three developments are significant. First, aggregate bank capital increased only slightly and failed to keep pace with the inflationary expansion of bank liabilities. Second, the increase of 103 offices of Government, provincial and municipal banks was accompanied by a decrease of fourteen offices of ordinary banks. Finally, the increase of 129 offices in central, western and southern China was accompanied by a decrease of forty-six offices in eastern and northern China.

A few ordinary banks suspended operations during 1937 and 1938, but some were able to resume their activities soon afterward; a few others were merged into larger institutions. The expansion of banking activities was characterized by the organization of new departments in existing institutions (trust, savings and agricultural credit), rather than by the establishment of new modern banks.

The conclusion is warranted that nothing stands out more clearly in the wartime financial development of free China than the increasing influence, power and prestige of the four Government banks. The rehabilitation of the country from the war's devastation, as well as the development of interior provinces, entailed greater Government leadership in the economic planning of the nation as a whole and a further consolidation

TABLE 36

BANKS AND BANKING CAPITAL

(capital in millions of national yuan)

	1937		1938		1939	
	No. of banks	*Capital*	*No. of banks*	*Capital*	*No. of banks*	*Capital*
Central banking group...	4	167.5	4	167.5	4	167.5
Local official banking group................	26	76.9	26	79.9	28	79.9
Ordinary banking group..	134	189.9	128	188.7	128	187.9

GEOGRAPHIC DISTRIBUTION OF BANK OFFICES

	1937		1938		1939	
	Head offices	*Branch offices*	*Head offices*	*Branch offices*	*Head offices*	*Branch offices*
East China Kiangsu and Chekiang	90	572	83	556	84	555
North China Hopei, Honan, Shansi, Shantung	16	359	16	344	15	338
Central China Anhwei, Kiangsi, Hupeh, Hunan	11	267	11	273	11	274
West China Szechuan, Kansu, Sikong, Shensi, Kweichow	18	167	21	198	22	233
South China Yynnan, Fukien, Kwangsi, Kwangtung	14	170	12	200	13	223
Northwest China Suiyan, Sinkiang, Chahar, Ninghsia	3	26	3	26	3	25
Foreign Countries	12	36	12	42	12	42

Source: *The Central Bank of China Bulletin,* June 1939; Spring 1941.

of the resources and facilities of the banks in particular. Chinese farmers and industrialists, failing to receive adequate facilities from private banking institutions, turned to the Government for financial assistance. Hence, Government banking agencies grew and expanded at a faster rate than in previous years. The concentration of banking activities and resources under Government control was perfected through the establishment of three new organs, the Joint Administration of the four Government banks, the Agricultural Credit Administration and the Foreign Exchange Control Commission.

Simultaneously, provincial and municipal banks, once the

financial instruments of local warlordism, were gradually integrated into the national banking system and transformed into active instruments of economic resistance.

Efforts were also made by the National Government to bring the ordinary banks under its control; however, the strength and initiative of these institutions were affected by traditional ties and interests in the occupied zone. The growth of private banking institutions and the development of organs of interbank co-operation and relationship ceased almost entirely. Consequently, the process of co-ordination between the private credit market and the agricultural, industrial and public sectors of the national economy came to a standstill.

As a result of these factors, the policy of State capitalism in the financial field was strengthened throughout the war. The concentration of the modern banking system under Government control and its expansion into free China were not accompanied by a corresponding modernization of banking technique. These conditions seemed to favor the development of a more balanced structure between the public financial institutions and the productive elements of the national economy, as the modernization of agriculture, industry and trade in the interior proceeded at an accelerated pace. However, the network of modern banking in the interior was spread over a limited number of commercial centers (about sixty or seventy cities) and was concentrated around two central money markets (Chungking and Kunming). Thus it failed to establish direct contact with the rural communities of farmers and of artisans—the backbone of China's economic resistance. The organization of a co-operative financing system, acting as an intermediary between the modern banks and the basic elements of China's economy, represented one of the most important achievements of the National Government.

THE RURAL CO-OPERATIVE CREDIT SYSTEM

Prior to the Sino-Japanese war, the growth of the rural co-operative institutions had been characterized by a lack of co-ordination and by the weakness of centralized financing. Since its inception in 1937, the Agricultural Credit Administration considered "the establishment of the basic structure of agricultural financing" as the essential step in the establishment

of Government control of, and assistance to, agricultural producers.

A system of co-operative banks, owned and managed by members of rural credit societies, was worked out by the Agricultural Credit Administration. A *hsien* co-operative bank could be established with a minimum capital of CN$100,000, jointly subscribed by the *hsien* credit co-operative societies and the local Association of Rural Co-operatives. Any deficiency in this minimum subscription was to be made up by the *hsien* authorities or banks, by agricultural banks, and by the Agricultural Credit Administration. The *hsien* authorities, banks, and other agencies were to withdraw their investment proportionately, as the investment of co-operative societies increased; representation in the management was to be changed accordingly, until the entire capital fund of the bank was owned and managed by representatives of credit societies. It was also provided that provincial banks could be organized by the Provincial Associations of Rural Co-operatives and participating provincial authorities, banks and non-profit organizations. A national co-operative bank was also to be established.

In line with the new policy, the Co-operative Law was revised in November 1939. The new regulations defined the credit co-operatives as those societies "organized for providing financial facilities—to grant loans to members to meet their productive and manufacturing needs and to accept deposits from the members" (Art. 3, No. 4). Credit societies could be authorized to accept deposits from non-members up to the total amount of the capital and reserve funds (Art. 5). The directors of credit co-operative societies were held responsible for the repayment of deposits; they were not relieved of this responsibility until two years had elapsed after their retirement from office (Art. 38). In brief, the Agricultural Credit Administration envisaged a rural credit system consisting of (a) the village credit co-operative society, as the basic credit distributor; (b) the *hsien* co-operative bank, as the lowest rural banking unit; (c) the provincial co-operative bank, as the co-ordinating financial agency, and (d) the national co-operative bank, as the central rural credit institution.

The growth of *hsien* co-operative banks depended upon the expansion of rural co-operative societies, which increased from

37,318 in 1936 to 78,312 in 1939 and 110,000 in 1941; 81 per cent were classified as credit societies and 6 per cent as integrated societies organized for general business, including credit. The number of credit and integrated co-operative societies in eleven provinces of free China[16] increased from less than 4,000 in 1936 to nearly 50,000 in 1939. By the end of 1941 the Agricultural Credit Administration had directed the establishment of 313 *hsien* co-operative banks. These banks operated in thirteen provinces of free China and were co-ordinated through four provincial co-operative banks in Szechuan, Kiangsi, Chekiang and Fukien.[17] Their chief function was the extension of personal loans to farmers through the co-operative credit societies; in addition, they handled savings, local remittances and rural insurance.

Only limited information was made available with regard to the resources and operations of co-operative banks. At the middle of 1939 these banks were still being financed mainly by agencies other than the credit co-operative societies; however, the latter were gradually absorbing the investments made by the other sources. Total investments in co-operative banks by outside sources, as of June 30, 1939, may be seen in table 37.

TABLE 37

INVESTMENTS IN CO-OPERATIVE BANKS, JUNE 30, 1939

(in national yuan)

	Funds Invested	*Repayments*	*Investments Outstanding*
Farmers Bank of China	66,238,853	34,703,779	31,535,074
Bank of China	16,710,374	4,811,161	11,899,213
Bank of Communications	4,080,963	1,240,824	2,840,139
Provincial banks	9,377,338	3,474,286	5,903,052
Agricultural Credit Administration	10,068,687	4,699,626	5,369,061
Provincial Co-operative Associations	3,029,015	1,897,911	1,131,104
Total	109,505,230	50,827,587	58,677,643

Source: *The Central Bank of China Bulletin*, Spring 1941, p. 24.

A survey prepared toward the end of 1939, by the University of Nanking in Chengtu, covering twenty-two co-operative banks, indicates that co-operative banks in Szechuan had reached a relatively high degree of maturity and that their

[16] Szechuan, Kiangsi, Hunan, Kweichow, Kansu, Shensi, Honan, Kwangsi, Yunnan, Kwangtung and Sikong.

[17] *China at War*, August 1942, p. 29.

credit was directed almost entirely into productive channels.[18] At the end of 1941 it was estimated that the loans extended by or through the Agricultural Credit Administration accounted for one fifth of all rural credit. Interest rates on such loans were kept artificially low, averaging upward of 12 to 14 per cent, and no provisions were made against their repayment in depreciated currency.

The results of the Agricultural Credit Administration's efforts to create an effective system of agricultural finance cannot be precisely evaluated. On the one hand, the Administration went far in the establishment of the basic structure of agricultural financing; the credit and banking co-operatives played a vital part in the rural mobilization of the country. Efforts were also made to bring about social and technical reforms in the co-operative system. The traditional orientation toward the well-to-do landlord class was considered too narrow, and new practices were devised to reach and include the lower-income farm-owners and tenants. Purchase of capital stock in credit co-operative societies was made easier—a down payment of half-yuan only, payable in cash or kind, gave immediate qualification for membership—and shareholders' liability was made limited instead of unlimited. Administrative procedure was simplified; more co-operative managers were trained; loans were made available at any time of the year, and their repayment in small installments over relatively long periods was permitted.

On the other hand, the Administration failed in its chief financial aim, which was to shift surplus funds from China's leading money markets to the rural areas, to be invested at a moderate interest rate; only public funds, not private savings, were pumped into the agricultural field. Moreover, bank and co-operative credit continued to be granted only for the seasonal cycle of rural production. Long-term credit for investment purposes, administered by the Agricultural Credit

[18] These banks started with an average capital fund of CN$4,000, borrowed about CN$1,000 from other agencies, had an annual credit turnover of more than CN$80,000 and made a net profit of CN$2,000 a year. According to the same survey, 9 per cent of bank loans were used for purchases of seeds, 23 per cent for fertilizers, 2 per cent for farming implements, 52 per cent for cattle raising, 3 per cent for foodstuffs, wages and rent and the balance for sundry purposes. The China Information Committee, *News Release,* January 15, 1941.

Administration, was rather insignificant and certainly not adequate to cover the needs of the country.

THE MODERN MONEY MARKETS OF OCCUPIED AREAS

One of the first steps taken by the Japanese-dominated Governments of occupied China was the establishment of banks of issue. Three central banks were in operation in occupied areas in December 1941; namely, the Bank of Mongolia in northwestern China, the Federal Reserve Bank of China in northern China and the Central Reserve Bank of China in central China. The introduction of a new currency standard necessitated an official control over foreign exchange and domestic credit; consequently, the new Governments adopted measures providing for the supervision of ordinary and other banking institutions. This resulted in the fragmentation of occupied China into a number of semi-autonomous money markets, characterized chiefly by the various degrees of their integration with the yen monetary bloc.

THE MODERN MONEY MARKET OF NORTHWESTERN CHINA

The Bank of Mongolia. Soon after the occupation of South Chahar by the Japanese Army, at the end of August 1937, the new Chanan (South Chahar) Government decided to set up a bank of issue. The Chanan Bank was duly founded on September 27, 1937, with head office in Kalgan; the institution was provided with a nominal capital of one million local yuan, advanced by the Central Bank of Manchou, and it took over the silver reserves of the Chahar Commercial Bank, which were deposited in Peiping and Tientsin. The bank marked with its identifying stamp some 1.3 million of local yuan currency and placed in circulation some quantities of old Manchurian notes of the Three Eastern Provinces Bank, then held in the vaults of the Central Bank of Manchou.[19]

Shortly after the establishment of the bank on November 22 1937, the district Governments of South Chahar, Suiyan and North Shansi were brought together under a Joint Committee, later transformed into the Federal Autonomous Government of Mongolia. As a consequence of this political change,

[19] Tokunaga, K., "The Progress of Monetary Unification in the Meng Chiang Provinces," *Kyoto University Economic Review,* January 1940, pp. 30-44.

the Chanan Bank was merged with two local institutions, the Northern Shansi Industrial Bank and the Feng Yeh Bank, and reorganized into the Bank of Mongolia. The new institution was provided with a paid-up capital of MC$3 million, held by the Autonomous Government and entrusted with the control of the money market, the functions of fiscal agent, the development of export trade, the administration of foreign exchange control and operations of ordinary banking business. The small silver reserves of the Chanan Bank were enlarged by the absorption of the silver stocks and acquisition of the yen exchange held by branches of modern banks and by local official and ordinary banks.

The Bank of Mongolia began its operations by withdrawing from circulation the national yuan notes and several other currencies (including the notes stamped or issued by the Chanan Bank, notes of the Central Bank of Manchou and the Bank of Chosen, subsidiary currency and silver and copper coins). At the end of 1937, the note issue of the new bank amounted to MC$13.0 million and was covered by a reserve of silver and yen exchange totaling MC$10.0 million. The policy of the bank was characterized by an uninterrupted expansion of currency, as indicated in the following table:

TABLE 38

NOTE ISSUE OF THE BANK OF MONGOLIA

1937–1941

(in millions of Mongolian yuan)

1937	December	13.0
1938	June	19.0
1938	December	38.1
1939	June	35.0
1939	December	65.1
1940	June	62.7
1940	December	94.5
1941	June	66.4

Source: *The Bank of Mongolia Monthly*

The extent of inflationary tendencies is disclosed in the remarkable growth in the reported loans of the Bank of Mongolia to the Government. These loans amounted to MC$115.7 million on December 31, 1940. Other reported assets of the bank on this date included MC$15.4 million in Government bonds and MC$17.9 million in shares of semi-official enter-

prises, including three banking subsidiaries, a trading company and various industrial undertakings (public utilities, petroleum, cement, flour, etc.). The importance of its official business may be gauged by the fact that 70 per cent of its loans and 16 per cent of its deposits were for Government account.

The chief private business of the Bank of Mongolia was the financing of cereal, opium and wool crops and their shipment abroad. However, as the Japanese authorities had fixed the prices on certain Mongolian export goods (such as wool, furs and flour) at lower levels than those prevailing in the Chinese markets, this trade from Mongolia tended to move toward free China and northern China, rather than toward Japan. The failure of the 1939-40 cereal and opium harvests placed the bank in a serious predicament, and it had to obtain "foreign" loans in order to readjust its exchange position. Between September 1939 and July 1940 the bank received credits from other banks (mainly from the Federal Reserve Bank of China) totaling nearly MC$16 million, in addition to an "exchange" loan of ¥15 million negotiated with the Industrial Bank of Japan, the Yokohama Specie Bank and the Bank of Chosen, under an agreement dated June 6, 1940. This loan was made repayable in one year, at an annual interest rate of 4.562 per cent, and renewable for two years; shares owned by the Bank of Mongolia and the Autonomous Government were pledged as security.[20]

The new Mongolian currency never was in a position to acquire an independent foreign exchange quotation. At the beginning, the Bank of Mongolia endeavored to maintain its stability according to the official rate of the national yuan in London (8d.); a form of foreign exchange control was introduced and remittances abroad were limited to MC$3,000. On October 25, 1938, new regulations brought the Mongolian currency into the yen bloc; consequently, its foreign exchange value was fixed in accordance with the official yen rate; i.e., at 1s. 2d. until October 25, 1939, and at $0.23439 afterward. Simultaneously, the new regulations co-ordinated foreign exchange control with Japanese monetary policy, by introducing a license system on all outward movements of goods and requiring that all export transactions be in yen exchange. Remittances abroad were limited at first to MC$1,000 and later

[20] *The Bank of Mongolia Monthly,* August 30, 1940.

to MC$500 (December 1, 1939) and MC$200 (July 8, 1940). Practically all foreign exchange transactions were handled by the Kalgan branch of the Yokohama Specie Bank.

Ordinary Banks. As the Japanese occupation of Inner Mongolia progressed, various bank branches controlled by the National Government or provincial authorities (Chahar Commercial Bank, Shansi Commercial Bank and others) suspended operations. The branches of the Bank of China, however, were not closed until late in 1939. In 1938 the Government proceeded to amalgamate several local banks into new banking institutions. Three so-called industrial banks were operating in Inner Mongolia in 1941, namely, the Industrial Banks of Mongolia, South Chahar and North Shansi. Their total paid-up capital was reported at MC$846,000, MC$879,000 and MC$616,000, respectively, most of which was held by the Bank of Mongolia. At the end of July 1940, the three banks showed deposits totaling MC$32.7 million, loans totaling MC$34.3 million and investments totaling MC$0.3 million. The Chinese Post Office, as well as the Central Bank of Manchou, also handled a limited amount of deposits. In 1941, the Bank of Mongolia endeavored to reduce the rates of interest prevailing on the market. Annual interest rates on deposits with Mongolian modern banks ranged from a low of 1.5 per cent on current accounts to a high of 6 per cent on 12-month fixed accounts. Annual interest rates on secured banking loans varied between 4.4 per cent and 11.7 per cent, while on loans not covered by collateral, rates of 9 to 12.8 per cent were reported.

THE MODERN MONEY MARKET OF NORTHERN CHINA

The Federal Reserve Bank of China. On March 10, 1938—shortly after the occupation of northern China by Japanese military forces and the establishment of the Japanese-dominated Provisional Government of the Republic of China in Peiping—the Federal Reserve Bank of China was opened for business with the avowed purpose of "stabilizing China's monetary and financial systems."

The bank was provided with an authorized capital of FR$50 million (one-half paid-up), consisting of 500,000 registered shares jointly subscribed by the Provisional Government and modern banks (Arts. 6, 7 of the Law of the Federal Reserve Bank of China). The subscription of the Provisional Govern-

ment (FR$12.5 million) was covered by a loan from the Yokohama Specie Bank, the Industrial Bank of Japan and the Bank of Chosen. The remainder (FR$12.5 million) was apportioned among the local branches of the Bank of China (FR$4.5 million) and the Bank of Communications (FR$3.5 million), and among the Provincial Bank of Hopei, the Bank of East Hopei, the Kincheng Bank Corporation, the Yien Yieh Commercial Bank, the China and South Sea Bank and the Continental Bank. The arrangements for payment of this second half of the capital were left to the discretion of the board of directors. Since the banks were instructed by the National Government to refrain from such participation, they did not subscribe individually, but instead they agreed to transfer to the Federal Reserve Bank of China the silver held for account of the Currency Reserve Board. Actual transfer, however, could not be effected at that time, as the silver was deposited in foreign concessions.

There were eight members on the board of directors of the Federal Reserve Bank of China and four members on the supervisory committee. There was a governor and a vice governor, and an adviser (Japanese) was entrusted with an active part in the bank's executive and business affairs (Arts. 17-29). The functions of the bank were those of a central bank of issue—including general banking business, management of the Government treasury, supervision of local banks, issue of notes and minting of coins, holding of monetary reserves and control of foreign exchange (Arts. 9-16).

The Federal Reserve Bank of China was accorded the privilege of issuing notes against a reserve of 40 per cent in silver, gold and foreign exchange and 60 per cent in Government bonds, commercial paper and loans to other banks (Art. 12). These notes were circulated at par with the yen currency. A number of measures were enacted with a view to eliminating the circulation of national yuan and provincial notes and enforcing the use of the Federal Reserve currency in North China.

The Law for Adjusting Old Currencies, enacted on March 10, 1938, provided that the circulation of national yuan notes issued by the Central Bank of China, the Bank of China and the Bank of Communications was to cease on June 10, 1938. The circulation of the northern notes (issued by the northern

branches of the Bank of China and the Bank of Communications and by the Provincial Bank of Hopei, the Bank of East Hopei and some thirteen other institutions) was to cease on March 10, 1939; until then, these notes were to be accepted and exchanged at par with the Federal Reserve currency. However, the depreciation in the free market value of the national yuan (from 1s. 2.250d. in March 1938 to 8d. in August 1938), while the official value of the Federal Reserve currency was maintained unchanged at 1s. 2d., was used by the Provisional Government as justification for a first devaluation of 10 per cent (effected on August 8, 1938) and a second devaluation of 30 per cent (effected on February 20, 1939) of the northern notes vis-a-vis Federal Reserve currency. Only the notes of the Provincial Bank of Hopei and the Bank of East Hopei were exempted from these two devaluations; they were allowed to remain in circulation for a two-month period (which was further extended) at par with the Federal Reserve currency, and the Federal Reserve Bank of China offered these two banks loans equal in amount to the notes redeemed during this period. Legally speaking, unification of the circulation through the issuance of Federal Reserve notes had been completed by March 10, 1939.[21]

In reality, the Federal Reserve notes had considerable difficulty in forcing their way into those zones where control by the Provisional Government could not be fully enforced. Between March 1938 and June 1940, the Federal Reserve notes were quoted in the open exchange market of Tientsin at a discount of 1.5 per cent to 30 per cent vis-a-vis the national currency. It was not until British and French authorities in northern China agreed not to obstruct the use of Federal Reserve notes (about June 1940) that the new currency began to be traded at a premium over the national yuan. However, in the districts held by Chinese guerrillas, the national and northern notes continued to circulate. This forced the Provisional Government to divide northern China into two general areas; namely, the Federal Reserve Bank area and the "bandit-infested" area. In the former, the circulation of northern notes was made illegal after March 10, 1939. In the latter, the ban against northern notes was to be enforced only upon restoration of

[21] All deposit and loan contracts stipulated in national yuan were converted into Federal Reserve currency by a decree of February 10, 1939.

order, with a notification period of two months, during which northern notes could be exchanged for Federal Reserve notes at 60 per cent of their original value.[22]

The monetary policy of the Federal Reserve Bank of China was characterized by an uninterrupted expansion of currency, deposits and loans:

TABLE 39

NOTES, DEPOSITS AND LOANS OF THE FEDERAL RESERVE BANK OF CHINA

1938–1941

(in millions of Federal Reserve yuan)

		Notes	*Deposits*	*Loans*
1938	Dec.	162.0	85.1	33.3
1939	June	264.2	159.8	101.2
1939	Dec.	458.0	180.3	162.1
1940	June	599.0	234.0	242.7
1940	Dec.	715.0	228.8	256.7
1941	June	680.0	342.0	..

Source: *The Federal Reserve Bank of China Monthly.*

The note issue of the Federal Reserve Bank of China experienced a remarkable, but not uncontrolled, expansion as compared with the amount of currency circulating in northern China prior to 1937. The latter figure was estimated at some CN$250 million to CN$300 million in notes of the Central Bank of China, the Bank of China and the Bank of Communications; CN$60 million in notes of the Provincial Bank of Hopei; CN$10 or CN$20 million in notes of the Bank of East Hopei and other local institutions, and several million in notes of the Central Bank of Manchou and the Bank of Chosen. Although the Federal Reserve Bank of China's efforts to eliminate these notes were not entirely successful, the volume in actual circulation was notably curtailed.

Against the issuance of notes, the Federal Reserve Bank of China was required to hold 40 per cent reserves in the form of gold, silver, foreign currencies or deposits in foreign currencies. At the middle of 1940, gold, silver and foreign deposits in the hands of the bank were reported to be near FR$300 million; presumably this included the "foreign ex-

[22] Tokunaga, K., "Monetary and Financial Reorganization in North China," *Kyoto University Economic Review*, April 1940, pp. 71-83.

change fund" which was established by the bank on October 5, 1938, by setting aside a portion of its assets in foreign currencies. These monetary reserves were accumulated in various ways.

First, the Bank of Chosen transferred FR$3.5 million in silver, and a Japanese banking syndicate advanced ¥100 million yen "to be used exclusively as exchange credit for settlement of Japan-China exchange accounts." Second, the Federal Reserve Bank of China bought silver and gold bullion in the open market and endeavored to gain physical possession of some 11.2 million ounces of silver held by Chinese and foreign banks in the foreign zones of Tientsin and Peiping for account of the Currency Reserve Board. In July 1940 Japan, Great Britain and France reached an agreement which brought about the sale of the equivalent of £400,000 from these stocks; the balance was sealed pending settlement of the Sino-Japanese war. Third, the Federal Reserve Bank of China converted into foreign exchange in Shanghai the national yuan notes which had been withdrawn from northern China. The amounts involved in such conversions cannot be estimated precisely, but they undoubtedly exerted a serious bear pressure upon the national yuan.[23] Fourth, the Provisional Government introduced foreign exchange control measures intended to concentrate foreign exchange in the hands of the Federal Reserve Bank of China and to co-ordinate the Federal Reserve currency with the yen monetary system.

The plan for foreign exchange concentration was put into effect on March 11, 1939. A notice issued by the Maritime Customs on that date provided that, in order to clear shipment of certain designated goods for destinations outside northern China, importers should present a certificate of sale of exchange (approved by the Federal Reserve Bank of China) to a bank authorized to deal in exchange. Simultaneously, the Federal Reserve Bank of China issued a proclamation stipulating that it would release exchange for imports to the extent to which it had obtained export exchange from authorized banks. In this initial stage, foreign exchange control aimed chiefly at

[23] As a defense measure, the National Government adopted measures of exchange control on March 14, 1938. These measures precluded the use of the monetary reserves of the National Government for redemption purposes at the official rates. However, national yuan notes could still be traded for foreign exchange in the Shanghai market at the free market rate.

the utilization of the proceeds of specified exports as import funds. However, further instructions, issued on July 17, 1940, brought the shipment of all goods under the exchange control provisions and provided that the Federal Reserve Bank of China should withhold 10 per cent of all export proceeds; this was done ostensibly for the purpose of building up foreign currency reserves and providing exchange for service transactions.

Since an export business was impossible at the official yen parity, the Federal Reserve Bank of China permitted exporters (and authorized banks) to sell (or "link") 90 per cent of their export exchange to importers of certain "approved" goods at a minimum "link" rate of 8.250d., or $0.16622. The minimum link rate was lowered on October 25, 1939 (when the yen and Federal Reserve yuan were divorced from sterling) to $0.13875 and was finally abandoned in November, 1940.[24]

The entire administrative procedure was calculated primarily to serve Japanese interests in China. In administering the exchange control, the Federal Reserve Bank of China extended special facilities to Japanese exporters for the collection of service charges at official rates and prescribed the quantities in which goods could be imported into northern China, and by what firms and from what countries such imports could be made. These discriminatory practices assumed a form of open financial warfare with the "freezing" ordinance issued on July 28, 1941 by the North China Political Council (which had succeeded the Provisional Government on March 30, 1940). This ordinance blocked American and British deposits in Chinese banks and suspended foreign exchange transactions for American and British account, as a "necessary countermeasure to the action of the United States in freezing the assets of China and her friendly neighbors." The administration of this ordinance was entrusted to a Central Special Assets Commission, composed of representatives of the Political Council, the Japanese Army, the Japanese Embassy, the Japanese Financial Commissioner and the Federal Reserve Bank of China, with the last named acting as agent of the Commission.

These measures placed the Federal Reserve Bank of China

[24] Tokunaga, K., *loc. cit.,* pp. 84-100.

nominally in the position of trade and exchange control agency of the Political Council. However, it was also made clear that the general policy was to be laid down by the Japanese Financial Commissioner in Peiping, to which the bank was to refer certain import applications. Moreover, the actual execution of foreign exchange policy in northern China was entrusted to the Yokohama Specie Bank, which acted as the foreign exchange agent for, and held the foreign exchange funds of, the Federal Reserve Bank of China. In brief, the Federal Reserve Bank of China played the minor role of a subsidiary central bank in the yen monetary bloc under Japanese direction.[25]

Ordinary Banks. The Japanese occupation and the establishment of a separate Government did not result in any serious disruption of the domestic money market of northern China. This was primarily due to the fact that, even before 1937, modern banks had been forced to adjust their business in northern China to conditions created by political autonomy and Japanese penetration.

While the Central Bank of China withdrew from the market entirely before the close of 1937, the branches of the Bank of China and of the Bank of Communications continued to operate as local ordinary institutions, having been deprived of all central banking prerogatives. In view of the existence of the exchange control, both banks closed the foreign exchange departments of their northern branches. Legally, the administration and operations of the branches were made independent of their head offices in Chungking and subject to control by the Federal Reserve Bank of China. Technically, the restrictions imposed upon monetary transactions between northern China and the rest of the country made it difficult for these branches to maintain any normal relations with the offices in central China, and least of all with those in free China.

Among the other modern banks, the Kincheng Banking Corporation, the Continental Bank, the Yien Yieh Commercial Bank, the China and South Sea Bank and the Joint Savings Society of these four banks continued to represent the most powerful and influential banking group of northern China. Since control of these banks was held by Japanese-educated bankers, and since their activities were concentrated in north-

[25] "Federal Reserve Bank of China—An Instrument of Japanese Economic Policy," *Foreign Commerce Weekly,* August 16, 1941.

ern China, they were scarcely affected by the hostilities and continued their operations under the new Government. No statements of the banks were made available, with the exception of those of the Joint Savings Society. These showed a decline in total assets from CN$116.8 million in 1937 to CN$93.8 million in 1941; a decline of CN$17.0 million in deposits was accompanied by a similar contraction in bills and accounts receivable. This contraction was probably due to the liquidation of branches in central China; in fact, after 1939 all modern banks in northern China reported increases in deposits and a general improvement in earnings. Evidently this was the result of the inflationary conditions prevailing there.

Modern banking institutions newly organized under the jurisdiction of the North China Political Council were few. The Shansi Industrial Bank, capitalized at FR$3 million (half of which was subscribed by the Federal Reserve Bank of China), opened for business in Taiyuan on July 1, 1941. Ostensibly a development bank, it probably took over the activities of the Provincial Bank of Shansi in the occupied area.

Regulations governing financial institutions dealing in deposits and loans, money orders and exchange were issued by the North China Political Council at the beginning of 1942. These regulations provided that financial institutions be organized as limited liability companies with a capital of FR$500,000 or more and be licensed by, and subject to supervision and control of, the Financial Section of the Political Council and the Federal Reserve Bank of China (Arts. 1-6; 11; 13-16; 19). Financial institutions were required to keep reserves with the Federal Reserve Bank of China and to register loans above certain amounts with the Financial Section; the directors of financial institutions were made jointly responsible for the liquidation of deposits, this responsibility continuing for two years after their resignation from the institutions (Arts. 9-10; 6). These regulations covered modern and native banks, as well as the money exchange shops.

The Rural Co-operative Credit System. The rural co-operative credit societies, which in northern China had reached an advanced stage of development under the auspices of the China International Famine Relief Commission, were placed under the control of the Ministry of Relief of the Provisional

Government. At the end of 1938 the societies numbered 662, with a membership of 59,698; funds advanced by the Ministry to the societies totaled FR$491,151.

THE MODERN MONEY MARKET OF CENTRAL CHINA

The China Development Commercial Bank. Soon after the Reformed Government of the Republic of China was inaugurated in Nanking, on March 28, 1938, reports were frequently circulated in Shanghai that a Government bank operating under the jurisdiction of the new regime was about to be established. Such a bank—the China Development Commercial Bank, commonly known as the Hua Hsing Commercial Bank—opened for business in Shanghai on May 16, 1939. The new institution did not claim to be a central bank. Its avowed purposes were to engage in general banking transactions (acceptance of current and savings deposits, discounts and loans, investment in securities and buying and selling of exchange, gold and silver) and to provide Shanghai and the adjoining provinces with a dependable note isssue which would have a fixed exchange value.[26]

The Hua Hsing Bank was established with a paid-up capital of HH$50 million, of which one half was contributed by the Reformed Government and one half by six Japanese banks; namely, the Industrial Bank of Japan (on behalf of the Yokohama Specie Bank), the Banks of Chosen and Taiwan, and the Mitsui, Mitsubishi and Sumitomo Banks. At the outset of its career, the Hua Hsing Bank deposited a large proportion of its funds (about 90 per cent) with foreign institutions, and on December 31, 1939, its deposits with bankers ("mostly on London and New York," according to the bank's statement) were officially given at HH$81.7 million. In the ordinary routine of business, exports and imports were financed, bills were discounted, and advances were made against approved securities. At the close of 1939, the bank's current and fixed deposits in Shanghai, Nanking and a few other towns were reported at HH$37.7 million.

Although accepted from the start in payment of customs duties and Reformed Government taxes, the Hua Hsing bank notes never gained circulation for ordinary commercial purposes, and the total issue never attained much more than

[26] *Finance and Commerce,* May 3 and 10, 1939.

HH$6 million. The new notes were not intended to have a different value from that of the national yuan, or to have any relation to the note issue of the Federal Reserve Bank of China. They were at first made freely exchangeable for the national yuan at par, and therefore pounds and dollars were to be made available to holders of Hua Hsing notes at a rate identical to that applicable for such purchases made with national currency. However, it was indicated that, should the national yuan register violent changes, the bank would endeavor to establish an independent exchange rate for its own notes.

Such a situation arose immediately after the bank's opening, when the free rate of exchange of the national yuan fluctuated sharply and fell from 8d. to 4d. Therefore, on September 1, 1939, the bank set a fixed rate of 6d. to one Hua Hsing yuan; simultaneously, instructions issued by the Reformed Government directed the public to pay customs dues and fees in Hua Hsing currency at the new official rate of 6d. The apparent object was to invest the Hua Hsing note with the recognized status of the Customs Gold Unit,[27] and assurance was given by the bank that no notes would be issued without a backing of 100 per cent in foreign exchange. It was recognized that progress was bound to be slow; probably the Japanese bankers in the management of the institution took the view that a free currency supported by the National Government and the Sino-British Stabilization Fund served their purposes better than would a controlled or manipulated currency, whose financial support they would necessarily be required to share.

Under these circumstances, the Hua Hsing Bank failed to develop to an extent commensurate with the size of its capital. In one sense, the bank represented an attempt at financial co-operation between Japanese bankers and the Reformed Government; military and political participation was lacking. Its note issue remained insignificant, and it is doubtful whether or not the whole of the capital was ever actively employed during the twenty months of its existence as a bank of issue.

At the end of 1940 the privilege of note issue was transferred to the new Japanese-controlled Central Reserve Bank of China, the deposit accounts in Hua Hsing currency were converted

[27] The Customs Gold Unit is the accounting monetary unit in which all customs duties are calculated.

into other currencies, and the Hua Hsing Bank was reorganized as a purely commercial undertaking. The bank's capital and reserve funds of HH$51.5 million were converted, at the rate of HH$100 to CR$175.75, into CR$90.5 million, of which CR$50.0 million was appropriated for the new capital and CR$40.5 million for two new reserve funds.[28]

The Central Reserve Bank of China. On March 30, 1940, the Reformed Government of China came to an end. Most of its members, old politicians of the pro-Japanese cliques which had ruled China in the years preceding the revolutionary war of 1927, disappeared from the scene. A new body of younger officials, secessionists from the ranks of the Kuomintang under the leadership of Wang Ching-wei, proclaimed the "National Government of the Republic of China" to be "returned" from Chungking to Nanking for the purpose of cooperating with Japan in the establishment of a "new order" in East Asia. From the beginning this secessionist group demonstrated its policy as being the continuation of those institutions, laws and forms which had been intimately connected with the legitimate National Government. This Japanese-dominated "National" Government was inaugurated on March 30, 1940, and it soon became evident that the establishment of a central bank "to unify currency systems with a view to stabilizing finance" was an aim toward which it would soon be directing its most serious efforts.

Before long, however, it was apparent that a conflict of views existed in Japanese circles on such questions of broad policy as the establishment of a central bank. During the summer of 1940 several missions of Japanese economists visited central China and gave out contradictory opinions regarding the immediate future of the national currency. In the meantime, it was announced that a plan for a "new currency order" had been worked out by a Sino-Japanese economic commission in Nanking and submitted to the Japanese Government for approval; the projected new bank formed an integral part of the plan. On the other hand, the opinion of Japanese businessmen in Shanghai was clearly in favor of supporting the stability of the national yuan and was therefore opposed both to the establishment of a central bank and to the prospect of a new note issue. There was also very considerable doubt as to whether

[28] *Finance and Commerce,* January 15 and February 19, 1941.

Japanese army circles in central China appreciated Wang Ching-wei's policy, and there were suggestions that they would oppose the organization of a new bank of issue on the grounds that the military yen served all purposes. Above all these considerations, however, there was the fact that the successful operation of a central bank and the introduction of a new note issue in central China could not be achieved so long as the new "National" Government could not obtain control over, or assistance from, the international sectors of Shanghai. Nevertheless, plans for the central bank were carried forward by the new "National" Government and, shortly after the signing of the Sino-Japanese Basic Relations Treaty of November 30, 1940, the opening of the Central Reserve Bank of China in Nanking on January 6, 1941, was officially announced.

The Charter of the Central Reserve Bank of China (issued on December 19, 1940) was an amended version of the law of the Central Bank of China passed in 1935 by the National Government. The Central Reserve Bank of China was defined as "the Bank of the State, established by the National Government" (Art. 1). The head office of the bank was set up in the capital (Nanking), branches were established in various cities of central China and agencies abroad were planned (Art. 4). The bank was capitalized at CR$100 million; this initial capital, subscribed by the Government, could be increased by private shares not to exceed 40 per cent of the total capital, with preference given to modern and native banks up to 30 per cent of the bank's total capital (Art. 2).

The management of the bank was entrusted to a board of directors, consisting of seven to eleven members appointed by the Government for a three year period; five of them were designated as managing directors (Arts. 6, 11). A Supervisory Committee was formed, with three to five members appointed by the Government for a two year period (Arts. 7, 12).[29] The bank was headed by a governor and a deputy-governor, appointed by the Government from among the managing directors (Arts. 8-10).

The bank was empowered to issue "national" currency and

[29] The charter of the Central Reserve Bank of China dropped the provision, contained in Articles 8 and 10 of the Law of the Central Bank of China, that representation in the board of directors and Supervisory Committee be granted to agricultural, industrial, commercial and banking interests and to the auditing department of the Government.

subsidiary notes and to circulate coins of the "national" currency minted by the new "National" Government (Art. 3). The maximum amount of note issue was subject to the approval of the Government (Art. 11), and the total of notes in circulation was to be announced publicly every week (Art. 22). Against its note circulation, the bank was required to hold cash reserves in silver yuan coins, silver and gold bullion, foreign currencies and deposits in foreign currencies, amounting to not less than 40 per cent of total reserves, the balance to consist of Government bonds or commercial paper (Arts. 20, 21). The notes were exempt from taxation (Art. 23) and were made fully redeemable in and convertible into national yuan or foreign exchange (Art. 19).

The authorized fiscal and business activities of the Central Reserve Bank of China (Arts. 3, 24) closely followed the Law of the Central Bank of China, and included:

(a) Acting as depository and fiscal agent of the Government;[30]
(b) Acting as agent of the Government in floating domestic and foreign loans and undertaking the service of such loans;
(c) Handling of receipts and disbursements of State enterprises;
(d) Holding banking reserves and handling inter-bank clearances;
(e) Accepting deposits of all kinds;
(f) Discounting Government paper maturing in not more than six months;
(g) Discounting commercial bills and acceptances maturing in not more than six months;
(h) Purchasing and selling drafts and bills of exchange maturing in not more than four months;
(i) Dealing in foreign currencies and bullion;
(j) Handling remittances and issuing promissory notes;
(k) Making loans against bonds and debentures issued or guaranteed by the Government;
(l) Undertaking trust business authorized by the Government.

The usual restrictions were provided with regard to acquisition of real estate (Art. 25); active participation in industrial and commercial enterprises; loans on the security of commodities; terms, collaterals and amounts of loans and advances; and financing of speculative operations (Art. 26).

The framers of the charter of the Central Reserve Bank of

[30] The bank had no authority to act as fiscal agent for provincial, *hsien* and municipal Governments or for public enterprises undertaken by such local Governments, or to designate the banks to act on its behalf in places where it had no branches. Such authority was contained in the charter of the Central Bank of China.

China showed a complete lack of originality and failed to take advantage of the experience of the four Government banks. The new bank was created with all the original defects of the Central Bank of China—i.e., the regulations covering its operations as Treasury agent were most inadequate, and the regulations with respect to its business activities had no practical application, owing to the lack of adequate credit instruments in the Chinese market. Oddly enough, the new charter entirely omitted any provision for the fixing of the discount rate, although it maintained all other provisions for discount operations. Admittedly, there was considerable obscurity as to what role the new bank was actually going to play.[31]

The policy of the Central Reserve Bank of China was outlined, on the occasion of its opening for business, by Mr. Chou Fu-hai, the Minister of Finance and governor of the bank:

> "The new bank is being established to avoid inflation and will issue its notes against ample cash reserve. The new notes are to circulate at par with the old at first, but if the value of the latter drops too far, the new notes will be stabilized to prevent disturbance to finance and the people's livelihood.
>
> "Cash reserves for the new notes not only exceed the 40 per cent provided for by the bank's regulations but have reached nearly 100 per cent. Therefore the new notes may be freely used to purchase foreign exchange or changed for national currency at par without restrictions for the time being in order to help circulation.
>
> "With a view to maintaining the value of the currency, efforts will be made to increase exports so as to balance foreign trade. Control measures on foreign trade will be adopted when necessary in accordance with Article 4 of the agreed terms of the Sino-Japanese Agreement.[32] Restrictions will be exercised on the importation of old national notes from Hongkong to prevent depreciation in the value of currency."

This statement seemed to indicate that, aside from the immediate problem of introducing a new legal tender, a long range plan was being worked out by the new "National" Government, by which the Shanghai free money market was

[31] *The People's Tribune,* January-February 1941, pp. 58-62.

[32] Article 4 of the Terms of Understanding signed on November 30, 1940, reads as follows:

"The Government of the Republic of China shall, in case they find it necessary to institute control on foreign trade, effect such control autonomously. They may not, however, infringe upon the principle of Sino-Japanese economic cooperation mentioned in Article 6 of the Treaty; and they shall consult with Japan with regard to such control during the continuation of the China Affair."

to be transformed into a closed and controlled market similar to that of Tientsin. Political control over the foreign sectors was undoubtedly an indispensable preliminary. At the end of 1940 the authorities of the French Concession in Shanghai acceded to the new "National" Government's demand that they surrender the Chinese District Courts situated in their territory. These courts promptly issued proclamations announcing that fees, legal deposits, etc., should be paid in Central Reserve currency and that if Chinese residents of the French Concession should "attempt to work against the circulation of these notes or refuse to accept same, they shall be punished without leniency." The ability of the International Settlement to resist similar pressure from the new "National" Government for any length of time was viewed with skepticism by the local bankers. However, the experience of the Hua Hsing Bank and the attitude of the Japanese army and Japanese business toward the establishment of a new bank of issue indicated that the Central Reserve Bank of China could not expect any support for its currency to be given freely by Japan. The establishment of the central bank was granted by the Japanese Government as a political concession to the new "National" Government's demand for financial independence; the consent was given reluctantly, as the Chinese plans for financial independence struck directly across Japan's schemes of planned economy in a yen bloc. Under such trying conditions, the progress of the Central Reserve Bank of China was bound to be slow. Expansion of the note issue during the first year was as follows:

TABLE 40

NOTE ISSUE OF THE CENTRAL RESERVE BANK OF CHINA

1941

(in millions of Central Reserve yuan)

Jan. 31	13.7
Feb. 22	19.8
Mar. 28	28.2
Apr. 19	32.6
May 30	43.1
June 28	64.6
July 26	76.2
Aug. 30	100.2
Sept. 27	103.1
Oct. 25	125.5
Nov. 22	156.2

Source: *The Central Economic Monthly.*

During its first year of existence, the Central Reserve Bank of China made no attempt to fix an artificial exchange value for the new currency, but limited itself to maintaining its free convertibility into the national currency at par. The use of the national yuan was permitted even for the payment of taxes, although all official budgetary appropriations of the new "National" Government were made in Central Reserve currency. The Customs Gold Unit was valued on the basis of CR$2.80 (compared with CN$2.707 used by the Central Bank of China); for the purpose of calculating this unit, the Central Reserve currency was valued at an official exchange rate of 6d. (as had been the case with the Hua Hsing currency).

The notes of the Central Reserve Bank met at the beginning with a passive boycott from the Chinese banks and active resistance from the foreign banks. Chinese banks in Shanghai were warned by the authorities at Chungking not to deal in or to accept any currency other than the national yuan, as such action would be regarded as treason. Nevertheless, Chinese bankers, whose political caution had developed into subtle diplomacy during China's endless turmoils, decided to conciliate the new authorities at Nanking by making deposits of small amounts with the Central Reserve Bank of China and by accepting accounts in the new currency if obliged to do so. However, they suggested a readiness to close their banks in case pressure should become too strong for large deposits or for subscriptions to loans issued by the new "National" Government and to shares of the Central Reserve Bank of China. The attitude of foreign banks was indicated by an informal agreement between British and American bankers in Shanghai "to the effect that they would have no dealings with the so-called new Central Bank or the currency issued by it and that the opening of accounts in the new currency is not contemplated by any of them." Eventually, the American and British freezing of Chinese assets and the countermeasures taken by the new "National" Government on July 30, 1941, precluded any dealings between the Central Reserve Bank of China and American and British banks. Last, but not least, the Japanese Army showed no propensity to assist the Central Reserve notes in gaining ground outside of Shanghai—as a matter of fact, in the interior the Central Reserve note found its most serious obstacle to be the military yen rather than

the national yuan. Whereas national currency and military yen were backed, respectively, by British-American financial resources and Japan's military and economic power, in the words of a local observer, "behind the Chinese Central Reserve Bank note there will be nothing but big political ideas."[33]

At the opening of the bank, on January 6, 1941, it was reported that its paid-up capital consisted of gold bars and foreign exchange (chiefly dollar exchange) amounting to $5.5 million, equivalent to CR$100 million. On the same date, the Treasury of the new "National" Government made a fixed deposit in foreign exchange and gold bars equivalent to CR$30 million. No further information was disclosed with regard to the strength of the monetary reserves. However, during July 1941 (immediately before the American freezing order) the Yokohama Specie Bank sold some $10 million to $15 million in the Shanghai market; this sum was believed to include the foreign exchange reserves of the Central Reserve Bank of China. It is probable, therefore, that these foreign exchange reserves were converted entirely into bullion and yen exchange.

The bank's activities were originally restricted to the provinces of Kiangsu, Chekiang and Anhwei; branches were opened in Shanghai, Soochow, Hangchow, Wusih and a few other localities. Wang Ching-wei and Chou Fu-hai had hoped to introduce the Central Reserve currency as the legal tender of all occupied China, by absorbing the business and note issue of the Bank of Mongolia and the Federal Reserve Bank of China and eliminating the use of the military yen; these hopes, however, met with an unco-operative attitude on the part of Japan. In the autumn of 1941, it was still evident that Japan continued to regard the Central Reserve Bank of China as a political concession to the new "National" Government and thus withheld any active co-operation.

It was only after the occupation of the International Settlement of Shanghai that Japanese authorities revised their attitude in order to use the Central Reserve Bank of China as a tool for acquiring control of the Chinese money market of Shanghai and extending the yen bloc, hitherto limited to northern China. Immediately upon the outbreak of hostilities in the Pacific, Japanese authorities fixed an official exchange rate for the national yuan and the Central Reserve yuan on the basis of

[33] *Finance and Commerce*, January 1, 1941.

the military yen, at CN$4 = CR$4 = 1 military yen. However, in the free market, which continued to be allowed, the military yen showed a strong tendency to appreciate. Consequently, on March 10, 1942, the Japanese authorities revised the official rate to CR$5 = 1 military yen, this rate no longer being applicable to the national yuan, the value of which was left to the free market.[34] Simultaneously, the new "National" Government at Nanking decreed that only Central Reserve notes were to be acceptable for official transactions and domestic remittances and instructed the banks to keep separate accounts in Central Reserve and national currencies. At the end of March, the Central Reserve Bank of China inaugurated a policy of gradual devaluation and redemption of the national yuan notes; the value of the national yuan currency was gradually reduced from the original parity with the Central Reserve yuan to CN$2 = CR$1 at the end of May 1942. At that point, the new "National" Government decided to withdraw completely the national yuan notes and to replace them with Central Reserve notes.

Regulations governing the conversion of the currency were issued on May 31, 1942; their application was restricted, until further notice, to the occupied areas of the provinces of Kiangsu, Chekiang and Anhwei. The regulations provided that the conversion of notes issued before 1941 by the Central Bank of China, the Bank of China and the Bank of Communications to notes of the Central Reserve Bank of China be effected during the period from the 8th to the 21st of June. Bank notes bearing the issue stamp of Tientsin, Paoting, Tsingtao, Shantung, Hankow and Chungking, as well as the notes of the Farmers Bank of China and those issued by the other three banks in 1941 or afterward were made ineligible for conversion; no provision was made for their withdrawal. Private holders were allowed to exchange up to CN$10,000, while exchange of sums in excess of this amount required a permit and were credited in the form of bank accounts. Financial institutions were given half of the counter value of their national yuan holdings in 5 per cent Finance Stabilization Bonds, non-negotiable and redeemable after twenty years, the other half

[34] The exchange rate between Central Reserve yuan and military yen was further revised by the Yokohama Specie Bank on May 20, to CR$5.55 = 1 military yen.

being credited to their account on the books of the Central Reserve Bank of China. Circulation of all notes in denominations of CN$1 or more, issued by the Central Bank of China, the Bank of China and the Bank of Communications was prohibited as of July 1, 1942; subsidiary currency and coins were permitted to remain in circulation at half the value of small denomination Central Reserve currency.

By the end of June 1942 the amount of CN$1,128.0 million had been reportedly withdrawn from circulation, while the note issue of the Central Reserve Bank of China, which had expanded from CR$546.0 million on March 21 to CR$825.3 million on May 23, 1942, rose by a further CR$202.0 million. As the foreign exchange holdings of the Central Reserve Bank of China were evidently inadequate to cover the expansion of note issue, at the end of July 1942, Governor Chou Fu-hai made arrangements for a currency stabilization loan of ¥100 million from Japan.

The first steps toward extending the area of circulation of the Central Reserve currency were taken in the summer of 1942, when the Central Reserve Bank of China was allowed by the Japanese military authorities to open branches in Hankow, Canton and Swatow.

The measures adopted by Japanese and Japanese-dominated authorities in central China during the first half of 1942 brought about a subordination of the local monetary standard to the military yen. This was probably a means designed to absorb gradually the Central Reserve currency into the yen bloc on a parity basis with the other yen currencies—this being the apparent aim of the Japanese policy in all occupied areas of Greater East Asia. The advanced inflationary situation and the war conditions were probably responsible for the gradual approach to the monetary problem of central China by the Japanese authorities.

Ordinary Banks. Upon the occupation of central China by Japanese troops, in 1937-38, modern banks immediately suspended operation of their branches in occupied territories and transferred the activities of these branches to a Shanghai office. This policy, at first adopted by the four Government banks, was followed by the Shanghai Commercial and Savings Bank, the Chekiang Industrial Bank, the National Commercial Bank and all other important banking institutions. Skeleton

staffs were maintained in certain large branches (Hankow, for instance) to carry on the liquidation of assets and liabilities, rather than to continue banking business. Consequently, the occupied areas of central China were left without modern banking services.

The establishment of new banks under the Reformed Government proceeded at an extremely slow pace. Aside from the Hua Hsing Commercial Bank, only one ordinary bank was reportedly established—the Soochow People's Bank with a capital of HH$500,000. It was not until the new "National" Government proclaimed its "return" to Nanking, in March 1940, that a number of institutions were organized by private and public interests.

The new "National" Government endeavored to apply the laws and regulations already in existence and to continue the banking policy of the National Government in Chungking. In September 1940, the Ministry of Finance at Nanking gave out its official views in this field as follows: (a) provincial banks should be devoted to economic reconstruction; (b) more *hsien* and municipal banks should be created; and (c) the establishment of banks for industrial and agricultural development should be encouraged, while the establishment of commercial banks should be discouraged because of the large number of such banks already in existence.

However, the actual growth of banks under the new "National" Government was confined to the commercial field. Between April 1940 and August 1941, five banks (four ordinary and one municipal) were opened for business in Nanking,[35] two banks (one ordinary and one municipal) were organized in Shanghai,[36] and a provincial bank was set up in Soochow.[37] During the second part of 1941, these banks were reported to be doing a flourishing business and reaping good profits in the occupied areas; in fact, they not only took advantage of the inflationary conditions but were also unhampered by competition from old established institutions.

[35] Agriculture and Commerce Bank (capital CN$3,000,000), Nanking Development Bank (capital CN$500,000), Nanking Commercial Bank (capital CN$500,000), Chien Hwa Commercial Bank (capital CN$1,000,000) and Nanking Municipal Bank (capital CN$1,000,000).

[36] Central Asia Bank (capital HH$2,500,000) and Shanghai Restoration Bank (capital CN$200,000).

[37] Kiangsu Local Bank (capital CN$1,000,000).

With the occupation of the International Settlement of Shanghai by the Japanese Army, in December 1941, the local branches of the four Government banks (the Central Bank of China, the Bank of China, the Bank of Communications and the Farmers Bank of China) were closed upon orders from the Ministry of Finance at Chungking, which announced that the powers and functions of responsible bank officials in occupied areas would henceforth be null and void and the assets and liabilities of the closed branches would be liquidated at the conclusion of the war. In the spring of 1942 the new "National" Government at Nanking and the Japanese authorities decided to liquidate the Central Bank of China and the Farmers Bank of China, in view of their hostile character, and to reorganize the Bank of China and the Bank of Communications as ordinary banking institutions. In the following July, a mixed Sino-Japanese commission, in charge of studying the position of these two banks, announced that branches of the Bank of China and the Bank of Communications in occupied areas would be reopened for the purpose of providing banking and remittances services and facilitating the circulation of the Central Reserve currency; and that shareholders who had no connections with the enemy would be given new shares in Central Reserve currency. In the Shanghai market, the number of banks permitted to engage in financial transactions was limited by the Ministry of Finance at Nanking to sixty.

Chaotic monetary conditions continued to prevail in those parts of occupied central China not under the direct jurisdiction of the new "National" Government. Japanese and local authorities made unsuccessful efforts to provide a working credit system. In Hankow the former Hupeh Provincial Bank was reorganized and reopened in May 1940, as the Middle Yangtze Industrial Bank. This bank was provided with a capital of 20 million military yen, entrusted with the function of fiscal agent for local authorities and authorized to issue its own notes, convertible only into military yen.

In southern China, the Kwangtung Provincial Bank was reorganized in November 1940, under the nominal auspices of the new "National" Government. The capital of the bank was reported to be CN$10 million, of which half was paid-up. War conditions prevailing in that zone confined the activities of the reorganized institution to the city of Canton.

CHAPTER XII

FINANCIAL PROBLEMS IN THE WAR ECONOMY AND POST-WAR RECONSTRUCTION

Five years of struggle against Japan have disrupted the long process of China's political and economic unification. Divergent tendencies have arisen in the occupied areas and in different parts of free China. While the Japanese purposely followed a policy of political and financial regionalism, the National Government undertook the development of southwestern China under centralized control, and the Communists, or those sympathetic to them, were at the same time developing northwestern China and the guerrilla areas largely on the basis of local autonomy. These underlying military and political factors characterize China's war economy. While peacetime political and economic forms will necessarily depend upon the final outcome of the war, they will be influenced to a very large extent by basic wartime trends which have already developed. An analysis of these trends is, therefore, essential to a study of methods and processes of post-war reconstruction.

THE MONEY MARKETS AT THE END OF 1941

The disruption of the process of unification has been particularly noticeable in the financial field. The native money market promptly adjusted itself to local conditions arising from the war and took advantage of the speculative opportunities in exchange, commodities and real estate. As a result, native banks at the end of 1941 were enjoying a boom, especially in those Japanese-occupied zones (the central and southern provinces) where the disappearance of modern banks had deprived entire districts and important financial centers of credit and monetary organs.

In the foreign money market, the Japanese occupation had forced foreign banks (other than Japanese institutions) to a standstill in Hankow, Canton, and other southern ports; they had been subjected to severe restrictions in Tientsin, Peiping,

and other northern centers, and could operate freely only in Shanghai, under the protection of international political control. Japan's domination fostered the expansion of Japanese financial interests all over occupied China. The Yokohama Specie Bank assumed in occupied territories the functions of both a special institution for international trade and a foreign department of the new Japanese-dominated central banks. Investments in basic economic enterprises in northern and central China were entrusted exclusively to two official Japanese holding companies—the North China and Central China Development Companies.

The freezing regulations adopted by the United States and the British Empire at the end of July 1941, as well as the retaliatory measures taken by Japanese authorities and Japanese-dominated governments in China, set up a system of foreign exchange control which brought the Shanghai free exchange market to an end. With the outbreak of war in the Pacific, the Japanese banks were placed in a position which gave them undisputed control of the Shanghai money market.

In the modern money market, the authorities of free and occupied China followed parallel courses of state capitalism throughout the war. The development of modern institutions in both zones continued to depend on political initiative.

In free China, basic changes in the financial structure were closely connected with the shifting of wartime Governmental activities from the coastal regions to the western and southern provinces. In this shift, nothing stands out more clearly than the increasing influence, power, and prestige of the four Government banks. The concentration of banking activities was advanced by the National Government through the establishment of three new organs, the Joint Administration of the four Government banks, the Agricultural Credit Administration and the Exchange Control Commission, and the reorganization of the central banking group. The rural co-operative credit system provided an intermediary link between modern banks and the rural economy of the country. However, the Government and the banks failed to develop adequate instruments for industrial financing.

In occupied China, the establishment of banks of issue and the introduction of new currency standards under Japanese domination resulted in a fragmentation of the country into a

number of regional money markets, characterized chiefly by varying degrees of integration with the yen monetary bloc. With foreign exchange and investment policies in Japanese hands, modern banks were restricted to the financing of domestic trade and speculation.

As a "no man's land," outside the jurisdiction of Chinese law, the foreign-administered areas of Shanghai continued to offer, until December 7, 1941, trading opportunities to free China's financial institutions, as well as to those institutions registered with Japanese-dominated authorities. After December 7, 1941, Japanese control closed the Shanghai market to free China's institutions.

With the spread of the Pacific war and the progressive isolation of China from the rest of the world, present and prospective financial trends continue to depend upon military and political developments in the Far East.

JAPAN'S FINANCIAL POLICY IN CHINA

Objectives of the Policy. There is considerable confusion with regard to the underlying significance of Japan's financial policy in China. The old colonial point of view, according to which "the Japanese hope to be influential in a 'Greater East Asia,' to draw foodstuffs and raw materials from this region, and to supply this territory with manufactured products of all kinds,"[1] fails to cover adequately the modern methods of economic domination. According to a Japanese moderate opinion, Japan's continental policy is guided by the following two principles:

"First, the primary consideration must be the establishment of a 'national defense economy' in this part of the Asiatic mainland and the development of heavy industry, with the war industries as its center, which hitherto has scarcely existed in the Orient.

"Second, as a most effective means of raising the funds necessary for developing heavy industry, every effort must be made to foster the textile and other light industries, which have so far played the most important role in accumulating the capital essential to Japan's industrial expansion."[2]

[1] Schumpeter, E. B., *The Industrialization of Japan and Manchoukuo, 1930-1940,* New York, 1941, p. 857; Mitchell, K. L., *Industrialization of the Western Pacific,* New York, 1941, p. 147.

[2] "Japan and the Inevitability of an East Asiatic Economic Bloc," *Ekonomisuto,* April 1, 1938 (transl. from Japanese in Institute of Pacific Relations, *Industrial Japan,* New York, 1941, p. 42).

The fundamental objective is not merely to secure raw materials or markets, but to build up "national defense industries" which facilitate armament, or, more plainly, assure an adequate supply of war materials. Capital formation is only a complementary element in the determination of Japanese financial policy in China.

These theoretical principles assumed legal form in the Treaty between Japan and China, signed by Wang Ching-wei on November 30, 1940. According to the Treaty and the annexed Agreed Terms of Understanding, the new "National" Government of China acceded to "economic co-operation" with Japan "in accordance with the principles of equality and reciprocity," on the following bases:

(a) "With reference to specific resources in northern China and Mongolia, especially mineral resources required for national defense, the Government of the Republic of China undertake that they shall be developed through the co-operation of the two countries. With reference to the development of specific resources in other areas which are required for national defense, the Government of the Republic of China shall afford necessary facilities to Japan and Japanese subjects.
"With regard to the utilization of the resources referred to in the preceding paragraph, while considering the requirements of China, the Government of the Republic of China shall afford positive and full facilities to Japan and Japanese subjects.
"The Government of Japan shall, with respect to the rehabilitation and development of industries, finance, transportation and communication in China, extend necessary assistance and co-operation to China through consultation between the two countries." (Art. 6 of the Treaty)

(b) "With regard to those industrial, mining and commercial establishments under governmental or private management which are at present controlled by Japanese forces, the necessary measures shall be taken for their prompt transfer to Chinese management in a rational manner, with the exception of those which are of enemy character or under special circumstances of unavoidable character, including military necessity." (Paragraph 2 of Terms of Understanding)

(c) "The Government of the Republic of China shall, in case they find it necessary to institute control of foreign trade, effect such control autonomously. They may not, however, infringe upon the principle of economic co-operation mentioned in Article 6 of the Treaty; and they shall consult with Japan during the continuation of the China affair." (Paragraph 4 of Terms of Understanding)

These "peace terms" were presumably intended to lay the foundation for Japan's projected postwar economic policy in China. Unquestionably, the legal terminology is sufficiently

vague to allow the Japanese Government a free hand in dealing with events as they arise. Yet these terms clearly give Japan a right of "eminent domain" over China, and their application would definitely exclude any autonomous development of the Chinese economy. Like Manchuria, China is slated to be developed as an integral part of a highly industrialized Japan. The long-term aims of Japan's policy have already been made unmistakably clear by the Manchurian experience[3] and by wartime trends in occupied China.

Techniques of Japanese Economic Domination. In the field of basic economic activities (raw materials and mining resources, communications and power and heavy industries) a system has been set up providing for the monopolistic exploitation of essential commodities, the use of existing Chinese capital and the promotion of new investments by the Japanese Government. The Japanese Government exercises political and financial control in this field through so-called national policy companies, which are semi-official holding companies established under the authority of the Japanese Diet. Their original paid-up capital was provided by the Japanese Government; Chinese capital was generally invited, but no steps were taken toward its actual participation. While these national policy companies maintain political and financial control, industrial and commercial control is entrusted to the Japanese managements of affiliated and subsidiary operating companies. These companies are legally Sino-Japanese governmental concerns—Chinese capital is represented by the value of the properties formerly belonging to Chinese companies, while Japanese capital consists of funds newly advanced by the holding company to the enterprises.

In the field of "capital formation activities" (which, accord-

[3] The foundations of the Japanese economic policy in Manchuria were enunciated in a *communiqué* of the Manchoukuo Department of Industry concerning the Productive Industry Control Law (released May 1, 1937) as follows:

"The development of Manchoukuo industries rests on the principle of integration of Japan and Manchoukuo. It excludes a separate economy for each of the two countries, and consolidates their economy as a whole. With regard to the outside world it aims to increase and strengthen the capacity for national defense in its broad sense. At home it has the ultimate object of improving and strengthening the people's economic condition. Accordingly, the kinds of industries which are to be developed are to be chosen and organized not only on the basis of local advantage or local consideration, but also from the viewpoint of their greater effectiveness in strengthening and consolidating the unit of economy which truly characterizes Japan and Manchoukuo."

ing to Japanese definition, are those economic activities yielding new investable funds through accumulation of profits—light industries, with textiles occupying the leading position), the practice of Sino-Japanese private combines has been adopted. The combines are characterized by a divorce of ownership and control—ownership is legally vested in a silent Chinese partner contributing plant, equipment and working capital, while control is reserved for a Japanese entrepreneur managing the undertaking. This practice has been adopted in the case of those factories which have been "returned" (according to the Agreed Terms of Understanding annexed to the Sino-Japanese Treaty of 1940) from Japanese Army control to Chinese ownership; it has also been extended to new undertakings. The system allows Japanese management to take advantage of the large supply of cheap labor and raw materials existing in China for the formation of new capital. In fact, from the Japanese point of view, these light industries are expected to play an important role in the balance of payments and domestic capital market of China. They are expected to provide foreign exchange balances (through exports) and corporate savings (through accumulation of undistributed profits), to be used for the purchase of capital goods abroad and to be invested in industrial developments at home on the basis of Japanese plans.

Chinese may be allowed to develop their economic activities autonomously only in those fields which are purely domestic and do not have any bearing upon national defense or capital formation.

These wartime practices and the legal phraseology are meant to shape China's future financial structure in accordance with the political principles regulating Sino-Japanese relations. Specifically, it would appear that:

(a) The planning and control of investment policies in China are to be reserved exclusively for the Japanese Government, which directs the flow of capital either directly (through semi-official holding companies) or indirectly (by supervising Sino-Japanese private undertakings). The large-scale requirements of the strategic industries make it necessary to restrict the flow of capital into nonessential industries; consequently, Chinese enterprises (which are restricted to the field of domestic consumption) continue to suffer from undercapitalization.

(b) Monetary and trade policy is to be nominally entrusted to Chinese authorities. The monetary policy adopted under Japanese direction by the new banks of issue in occupied China is designed to establish and maintain a decentralized system of regional money markets, characterized chiefly by the varying degrees of their integration with the yen monetary bloc. In applying measures of foreign trade control, China may not infringe upon the principle of Sino-Japanese economic co-operation and must consult with Japan during the continuation of the war. The actual execution of the foreign exchange policy is entrusted to official institutions of the Japanese Government and the administrative procedure is calculated primarily to direct credit and trade (particularly in the field of essential commodities) according to Japanese requirements.

(c) Credit and monetary transactions (e.g., domestic commercial banking operations) which do not affect the investment field or the external position of the currency may be autonomously managed by Chinese banks.

It is evident that the application of the principle of "economic co-operation" contained in the Treaty of 1940 and the continuation of the present policies would give Japan the dominant role in China's capitalistic development and her foreign economic relations. This policy would have important economic and political consequences.

Economic and Political Consequences. Under Japanese domination, China's economy would be developed on a regional, rather than national, basis and according to foreign (i.e., Japanese), not domestic, needs. Regional development would facilitate the diversion of China's economic resources to Japanese uses; exploitation of raw materials and the building of factories would be determined according to Japan's war and peace requirements. Evidently, as Japanese initiative would penetrate those fields which are complementary to, and eliminate those activities which are competitive with, the Japanese economy, the development of the various areas and branches of the Chinese economy would be very unequal. As a result, the basic structure of China's economy would remain highly unbalanced, probably with an over-development in certain areas of industries producing and processing raw materials for foreign (i.e., Japanese) use and a general underdevelopment of industries producing capital goods and satisfying domestic consumption. Such a process would provide China with

specialized and localized productive capacities, which would become the appendage of a highly diversified foreign economy, that of Japan.

This economic process would clearly have a definite bearing upon China's future political position. Only countries with a diversified economy, such as Japan's, are in a position at the present time to compete on equal terms—economically, politically and militarily—in the international field. Internally, a diversified industrial structure alone can provide the economic and social environment within which independent political forms can be expected to develop and grow. Moreover, a regional economic development would create a basic social structure obstructing any future process of political unification. Thus, Japan's policy is not necessarily directed against the building of industries in China, but it is clearly directed against the development of a diversified national economy and, consequently, against the creation of a modern and independent China.

This policy far exceeds the traditional forms of colonial domination. In the decades preceding the establishment of the National Government, financial supremacy in quasi-colonial countries, such as China, was used by foreign countries with a view to pecuniary returns for their banking and mercantile communities and the acquisition of raw materials and disposal of manufactured goods by their national industries. Colonial expansion and opening of new markets were synonymous in the political and economic sciences. Under the modern forms of totalitarian imperialism, military concepts have been introduced—the value of a dependent territory is not measured in terms of private profits, but on the basis of its contribution in materials and manpower to the military machine of the dominating country. Accordingly, financial control is designed to integrate dependent territories in the strategic system of the dominating country; thus it becomes a conscious and effective instrument of military policy for the permanent subjugation of foreign countries.

WARTIME FINANCIAL POLICY OF THE NATIONAL GOVERNMENT

The financial policy of the National Government under war conditions has been marked by unprecedented outlays in excess

of revenue from taxation and savings with resulting expansion in note issue and inflationary pressure upon prices.

Revenue. The outstanding feature of China's tax system in pre-war years was that three sources of revenue, customs duties, the salt tax and the consolidated tax on commodities, were responsible for an annual yield of about CN$800 million, or about 80 per cent of the total revenue of the National Government. It is difficult to estimate the total loss due to Japan's seizure of the richest provinces, the naval and land blockade and the general disruption of the national economy. Customs revenue in free China's ports amounted to about CN$70 million during 1938 and CN$50 million during 1939, and probably did not rise above CN$75 million during 1940; collections during 1941 probably were much smaller, owing to the sharp curtailment of commercial (taxable) traffic. The decrease in the salt revenue is difficult to estimate, but the increase in receipts in some parts of the country undoubtedly failed to compensate for the considerable losses of the salt fields in the northern provinces; the revenue from this source after 1937 may be guessed to be from CN$50 million to CN$60 million a year. The yield of the consolidated tax (collected on the production of cotton yarn, flour, sugar, tobacco and cigarettes, alcohol and wines, etc.) dropped to insignificance with the loss of the industrial cities of Shanghai, Tsingtao, Wusih, Hankow and Canton. The total reduction in the fiscal revenue from the three sources is generally estimated at a minimum of 80 per cent of the pre-war level.

On the other hand, taxes on consumption were generally increased, probably bringing in some hundred millions of national yuan in 1941, and direct taxes (income, inheritance and excess profits), which had accounted for a negligible sum before the war, came to represent an important source of revenue, estimated at nearly CN$100 million for 1940 and about CN$150 million for 1941. Income from Government enterprises and monopolies undoubtedly expanded, owing to the rise in prices and to new lines of foreign trade developed and monopolized by the Government; the total revenue from this source may be estimated at CN$300 million to CN$500 million. In all likelihood, the National Government's revenue ranged from CN$600 million to CN$2,000 million a year—probably nearer the former figure in 1937-38 and the latter

figure in 1941. There has, therefore, been no net loss of money revenue as compared with pre-war figures of about CN$1,000 million a year. If the external depreciation of the currency and the rise in prices are taken into consideration, however, the net loss of "real" revenue between 1937 and 1941 might amount to 80 or 90 per cent.

As this situation obviously called for radical readjustment, drastic steps were taken. The fiscal scheme adopted by the Third Financial Conference, which convened at Chungking in June 1941, amounted to an administrative revolution. The land tax, heretofore collected on a cash basis by provincial and *hsien* (district) authorities, is now collected in kind by the National Government; as in the case of other taxes, however, collection is not equally effective in all areas. Similarly, beginning in 1942, provincial budgets are included in the national budget, with emphasis on an equitable development of the various provinces; district treasuries are allotted fixed shares of the national taxes and permitted to introduce certain local levies. The measure, along with further increases in indirect taxes, expansion of fiscal monoplies and changes in prices, may possibly raise the total National Government money revenue to CN$5,000 million or more during 1942.

Expenditures. On the expenditure side, it is believed that the annual outlays of the National Government expanded from CN$2,100 million during 1937 to some CN$10,000 million during 1941, and may well reach nearly double the latter figure during 1942. According to an official statement, national defense expenditures during 1940 amounted to 53 per cent of the total, while civil expenditures were said to have been distributed as follows: loan service (22 per cent of total expenditures); reconstruction, communications, education and cultural affairs (19 per cent); administration and miscellaneous (6 per cent). Aside from national defense, loan service continued to be the largest single item in the budget. Productive expenditures were relatively small.[4]

This rough analysis would indicate that total expenditures of the National Government during the period 1937 to 1941 inclusive amounted to some CN$25,000 million, of which

[4] *The Central Bank of China Bulletin,* Winter 1940, p. 499. In recent years, the budget of the National Resources Commission, which is in charge of most Government industrial undertakings, amounted to only 1 or 2 per cent of the total Government budget.

probably not more than one-fifth was obtained through fiscal revenue. The balance was covered by bond issues, foreign credits and current borrowing.

Bond Issues. The Government bond issues consisted of two types: so-called gold bonds and loans in national currency. The gold bonds are not actually linked in any way to the metal, but are denominated in Customs Gold Units,[5] pounds sterling and dollars. Loan service and redemption in respect of subscribers abroad take place in dollars or pounds, while domestic subscribers are paid in national currency at the "trading" exchange rate.[6] The amount of gold bonds reported sold between 1938 and 1940 was considerable, totaling 100 million Customs Gold Units, £20 million, and $100 million, the whole equivalent at then prevailing exchange rates to approximately CN$1,150 million.

Loans in national currency without exchange guarantee were reported to have been issued by the National Government up to CN$3,430 million during the first three and a half years of war. With the exception of the first loan, issued in 1937 in the open market for a nominal amount of CN$500 million, these loans were almost exclusively taken by the four Government banks in settlement of previous advances. It may be assumed that the Government banks found it difficult, or even impossible, to unload in the market any significant amount of their bond holdings; consequently the issuance of new bonds failed to bring about any contraction of banknote circulation.

The capacity of the Chinese banking system to absorb Government loans, however, has by no means been exhausted. As a result of credit creation by the central banking group and the repatriation of funds which had taken refuge in Shanghai and abroad, current deposits in free China increased enormously after the middle of 1940. The extent to which the lending capacity of the banks might be used largely depends

[5] The Customs Gold Unit is an accounting currency, originally based on a hypothetical gold content of 0.601866 grams of gold, equivalent to $0.677268. Before the opening of the Sino-Japanese war, its prevailing rate in national currency was 1 Customs Gold Unit = CN$2.260. In October 1939 its value was arbitrarily fixed by the Central Bank of China at CN$2.707. In April 1942 the Ministry of Finance raised the theoretical gold content of the Customs Gold Unit to 0.888671, placing it on a theoretical gold parity with the dollar.

[6] The "trading" rate was adopted by the Bank of China in July 1939, on the basis of 7d.; it was reduced to 4,500 d. in August 1940.

on the form in which deposits are kept and the methods by which loans are floated. Official savings campaigns to induce the public to convert bank deposits into fixed accounts or to subscribe directly to Government bonds failed to attract any sizable amount of floating funds. The National Thrift and Reconstruction Movement, which was started under the auspices of Generalissimo Chiang Kai-shek in September 1940, resulted in the opening of fixed accounts with official banking institutions for CN$725 million by June 1942. In April 1942 the National Government decided to use part of the $500 million and £50 million loans from the United States and Great Britain as security for the domestic issue through voluntary and compulsory subscription of Allied Victory Bonds and Savings Deposit Certificates, to be bought by the public in national currency up to the equivalent of $200 million and redeemable in foreign currencies in from one to ten years. Although no undue hopes were placed in these bond issues, it was thought that they might contribute toward freezing a portion of the floating funds and shifting some speculative hoarding from goods to foreign exchange; this would have the effect of increasing the flow of goods into the commercial market and would counteract the inflationary trend to some extent.

Foreign Credits. It is impossible to determine precisely how the use of foreign credits fits into China's budgetary system. From the standpoint of administrative procedure, as foreign exchange credits are held by autonomous Government agencies (Central Bank of China and Central Trust of China; Universal Trading Corporation, for American trade; Exportleb, for Soviet trade; etc.), their use for Government account creates a liability in national yuan due from the National Treasury to the autonomous agencies. As a consequence, the use of foreign balances by the Government is technically part of the internal, rather than external, public borrowing. The use of foreign credits provides the National Government with purchasing power which shifts the financial burden from the borrowing country—China—to the lending countries—the U.S.S.R., the United States and Great Britain—to the extent that foreign supplies are made available under the credits; to the extent that repayments are made, the financial burden reverts to China. As information concerning Government pur-

chases abroad is a guarded military secret, we shall consider below only those loans which were clearly intended to finance the National Government.[7]

During the first year of hostilities foreign loans were insignificant. A £10 million credit was negotiated with the Government of Czechoslovakia for the purchase of general supplies, and two railway loans, totaling 630 million French francs, were obtained from a French banking group. However, the Czech credit was not used, and relatively small sums were paid out of the French loans; repayments were presumably effected, but this is not certain. A £20 million purchase credit, extended by Belgium in March 1939, probably remained unused.

In October 1938 the first of a series of four loans based on barter agreements was negotiated with the U.S.S.R.; the total Soviet advances amounted to 1,500 million rubles. Probably only about half had been disbursed by the middle of 1941, when Soviet shipments of mechanical equipment and other war materials to China were restricted. Deliveries of mineral and agricultural products from China were scheduled to take place during a period of from 5 to 10 years, beginning in 1938. It is likely that China received supplies from the U.S.S.R. worth some CN$500 million at official rates (1 ruble = CN$0.63) and CN$3,000 million at the prevailing free rates of the national yuan; probably one-third was covered by repayments.

Loans made in 1938 and 1940 by the United States through the Export-Import Bank, for agricultural and industrial products, amounted by the end of 1941 to $120 million, of which $92.1 million had been disbursed and $26.8 million had been repaid. On the basis of current free rates, disbursements and repayments amounted to about CN$1,500 million and CN$500 million, respectively.[8]

British assistance to China was on a much smaller scale. Of the loans for commercial and railway purposes, totaling £18

[7] Other foreign balances, such as those arising from the liquidation of the silver stock or obtained through monetary arrangements, were used by the National Government and its agencies for general currency stabilization purposes, rather than for covering specific Government expenditures abroad. Foreign material assistance provided through lend-lease (after April 1941) was probably not included in the budgetary system of the National Government.

[8] By the end of June 1942, disbursements on these loans had increased by $3.3 million (CN$61.0 million) and repayments by $6.2 million (CN$114.7 million).

million, probably less than £10 million was used and less than £5 million repaid; the outstanding used balance, as of the end of 1941, probably amounted to a few hundred million national yuan at the then prevailing free rate.

Thus the total net foreign contributions to China's war effort up to the end of 1941 may be estimated at less than CN$3,000 million—but it is not clear whether this sum should be added to, or included in, Government expenditures as estimated.

Central Bank Credit Expansion. As the required diversion of the flow of money from the private to the public sector could not be achieved by taxation and savings alone, current borrowing from the four Government banks and, in consequence, money printing, represented the only alternative method of filling the monetary gap. Between June 1937 and December 1941 the note issue of the four Government banks rose by an estimated CN$13.5 billion. This figure is closely equivalent to the estimated monetary deficit between Government receipts (from taxes and savings) and expenditures (for civilian and military purposes). It would then appear that from 50 to 60 per cent of the public outlays were financed through inflation. Under the impact of the war, the characteristic inflationary cycle—currency, prices, currency—could never be interrupted and led to the steady depreciation of money in terms of goods. There is no doubt that free China is in the midst of a most serious inflation. Wholesale prices (as measured by the Chungking index) were approximately twenty-seven times higher at the end of 1941 than in the middle of 1937; and currency expansion (at a rate of perhaps CN$1,000 million a month) and rapidly rising prices (by about 10 per cent a month) have continued to prevail during 1942.

The prerequisites to a policy of war finance free from the outward effects of inflation are two: a supply of civilian goods considered adequate according to current social standards, and administrative efficiency in revenue collection and in the control of commodity distribution. It is clear that these two prerequisites do not yet exist in free China. The ever-expanding war demands of the National Government can be met neither by increasing productivity nor by voluntary or planned reduction in civilian consumption. Transportation difficulties make it impossible for free China to depend upon foreign supplies to any significant extent. Inflation represents a method of capital

levy and forced savings; despite the social dislocations it causes, it is for China a practical means by which the Government can acquire the purchasing power which it needs and must perforce use in competition with that in the hands of the public.

The Economic Effects of Inflation. It is difficult to evaluate precisely the economic effects of the inflation. Credit expansion at low interest rates and the rise in prices contributed toward alleviating the financial burden of the rural communities. On the one hand, the indebted farmers, who had mortgaged their land or sold it maintaining the customary redemption right, proceeded generally to regain free title to their property by repaying pre-inflation debts in inflated currency. There were few new land transactions after 1938, chiefly because the cases of distress sales from indebted farmers were reduced. Moreover, there was no general improvement in the utilization of land, as farm implements could not be easily obtained, a shortage of farm labor developed and costs of operations soared, with the result that land investment failed to attract speculative attention. On the other hand, rural landlords took the opportunity of returning to their tenants the cash deposits (representing the guarantee for the payment of rent) at one-thirtieth or even one-fiftieth of their original pre-war value in terms of rice and demanded new guarantee deposits at rates approximately thirty times higher. The landlords frequently used the money from these new deposits from tenants or from borrowing through the local co-operative society for increasing their hoarding of rice. Professional money lenders, shop owners and landlords, who still are the predominant sources of funds for small farmers and tenants, adopted the rule of fixing and collecting their loans, interest and rent in kind instead of money. The uncertain price movements and Government requisitions apparently affected the middle strata of farmers more severely than rich landlords or tenants. Consequently, under the inflationary conditions the rural community achieved greater financial liquidity on the whole, but the war brought about a process of polarization among the various classes and a technical deterioration in the productivity of agriculture. Aside from this, the inflationary policy of the National Government had two distinct effects —industrial development in the interior and hoarding.

Unlike the situation in more advanced countries, where the chief task in time of war is to secure the efficient utilization of

existing equipment and the transfer of productive resources from peacetime to wartime needs, China's big problem has been to create new productive plants and to expand the volume of production of both military supplies and consumer goods. According to a report of the Ministry of Economic Affairs, which is believed to include all free China's industrial enterprises regardless of size, the value of industrial production rose from CN$700 million in 1938 to CN$1,450 million in 1939 and CN$3,400 million in 1940.[9] Even more important advances were reported for 1941. This expansion—equivalent in stable wholesale prices (as measured by the Chungking index) to about 10 per cent a year—is particularly significant in view of the technical difficulties under which production is carried on. Money capital can be turned into productive investments only as long as there are materials and labor available. Economic development in free China is restricted, not by want of money capital (which is artificially created by the issue banks' financing of government deficits), but by shortages of capital goods and equipment, the extremely inadequate system of transportation and the lack of skilled labor and technicians.

The development of strategic industries (mining of strategic metals, manufacture of military supplies and electrical enterprises) is reserved exclusively to the National Government. The Government's management of these industries is characterized by monopolistic practices and based on political and military considerations. Consequently, the level of production in this public sector is not dependent upon the relative trends of costs and prices. In the private sector, primarily devoted to production of consumer goods for the army and civilian population, the uninterrupted rise in prices has created conditions favorable to full employment of existing resources, with a mushroom growth of marginal activities. According to the Ministry of Economic Affairs, 448 private factories (chiefly textiles) were in operation in free China at the end of 1940, excluding home industries and small workshops; in addition, the industrial co-operative movement, launched in 1938, brought into existence 1,358 units by September 1939, 1,688 by May 1940 and 1,737 by December 1941.[10] These co-operative

[9] *The Central Bank of China Bulletin,* Summer 1941, p. 219.

[10] *Ibid.,* p. 218; Wales Nym, *China Builds for Democracy: A Story of Co-operative Industry,* New York, 1941, p. 206; *China At War,* June 1942, p. 39,

enterprises are generally financed through loans and operate at progressively higher prices for their output. This basic condition permits them to operate at unusually high costs of production, and any restriction on their borrowing or any policy of price stabilization could not fail to have an important deflationary bearing upon such productive activities.

Recognition of the existence of this productive element in the inflationary process should not lead, at the present stage, to under-estimation of the parasitic influence of commodity hoarding. Logically and historically, the inflation preceded the hoarding. During the first three years of the Sino-Japanese war, the price of food was conspicuous for its stability; the rural areas in the interior, which enjoyed two exceptionally good harvests in 1938 and 1939, absorbed and hoarded a considerable amount of bank notes, thus attenuating the general effects of monetary expansion. In 1940, a bad harvest—which was reported to have been about 50 per cent below normal—caused foodstuffs to take the lead in the rate of increase of prices; hoarding shifted from bank notes to grains and staple commodities, thus accelerating the velocity of circulation. This situation continued to prevail during 1941; in 1942 increasingly acute shortages in manufactured goods affected adversely the price trend despite comparatively favorable food supplies.

The hoarding of commodities is a profitable investment when prices are rising rapidly; this type of investment involves private money, as well as mercantile and banking funds. As hoarding becomes more widespread and covers a broader range of goods, it enhances inflation by withholding supplies from the commercial market; it further disrupts the economic life of the country by withholding credit from productive activities. Administrative measures against hoarders and their financing are necessarily limited in effectiveness, so long as floating funds (cash and current accounts) are not fixed in savings accounts and their use is not diverted from the private to the public sector of the national economy.

The National Government is now confronted with the difficult task of controlling a dangerous inflationary process. The most urgent problem is not how to arrest the expansion of

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October 1942, p. 28. A policy of consolidation was inaugurated in 1941. A total of 700 industrial plants was reportedly registered with the Government in the province of Szechuan at the middle of 1942.

note issue or even the rise of prices, which under war conditions are bound to persist, but, first, how to propel newly-produced consumer goods into the market and, second, how to absorb newly-formed floating funds. The National Government has taken steps in both directions. The collections of the land tax in kind is mobilizing rice and grain which will be used to satisfy the Army's consumption needs and to counteract local food shortages. The issuance of dollar-secured bonds and certificates is designed to absorb floating funds and to shift hoarding from commodities to foreign exchange. The success of these measures will depend almost exclusively upon the administrative efficiency of the collecting agencies and the public's confidence in the new bond issues. In case of failure, the possibility of more drastic action, such as the introduction of a new monetary standard and the liquidation of the present note issue, may be considered. Significantly enough, in April 1942, the Ministry of Finance revalued the Customs Gold Unit from 0.601866 gold grams to theoretical parity with the dollar, or 0.888671 gold grams, and announced the placing in circulation of some 100 million Customs Gold Unit notes (equivalent to CN$2,000 million). The theoretical parity with the dollar may possibly give the new gold notes the prestige that the national yuan currency has lost, especially if free convertibility of the gold notes into "frozen" dollar accounts were to be allowed.

FIANCIAL PROBLEMS OF POST-WAR RECONSTRUCTION

Inflationary processes and disintegrating influences are destined to characterize China's financial trends under war conditions and economic isolation. In post-war China, financial reorganization will be the basic prerequisite to economic reconstruction; but the peacetime forms of China's financial structure will be determined largely by basic wartime trends. The possibility of integrating the divergent tendencies existing in free and occupied China into a single unified scheme of national development will depend upon the political settlement of the war. The magnitude of the task which will confront the National Government after the war will depend, in particular, upon the length of Japan's occupation of Chinese territory.

Monetary and Banking Reform. China's immediate post-war financial need will be a monetary reform. This will involve

withdrawing and reorganizing the various domestic note issues in circulation and adjusting the external value of the national currency (maintained during the war at an artificial exchange rate) to its internal purchasing power. The reopening of China's hinterland to international trade may have a deflationary effect upon the sky-high price level reached under conditions of war and economic isolation. Nevertheless, the adjustment of the external value of the currency to its internal purchasing power will undoubtedly require a radical devaluation, which will necessarily have far-reaching economic and social consequences. The unification of control over central banking functions and reorganization of the ordinary banking system will be essential to the success of the monetary reform and to the re-establishment of a working credit structure.

The policies followed by the authorities of both free and occupied China represent a strong tendency toward state financial capitalism, while in the northwestern border district and in the guerrilla bases some remnants of feudalism and considerable elements of a primitive quasi-socialist economy exist. The expansion of public financial agencies in both free and occupied China has been accompanied by an uninterrupted deterioration of the private credit system. These basic trends are conducive to political, rather than economic, techniques of finance; after the war, initiative, resources and control will presumably continue to be held and exercised by the Government. This underlying political factor will determine the ways and means by which capital for reconstruction will be raised and distributed.

Unified control of central banking functions is now and probably will continue to be the fundamental problem of China's financial administration. Considerable progress in this direction has been made during the war, and actual separation of the fields of activities of the four Government banks has already been decided upon by the National Government. Desirable as this change is likely to be from a long-term viewpoint, its importance to the early period of post-war reconstruction should not be over-estimated. More urgent tasks will be the internal reorganization of the four Government banks and the liquidation of the Japanese-dominated banks of issue. The four Government banks are being burdened with war advances and the financing of wartime economic activities. Liquidation

of losses will probably proceed along the usual lines; i.e., delivery of long-term bonds from the National Treasury to the banks. The intimate relationship between the Central Bank of China and the Ministry of Finance has resulted in a deterioration (to some extent inevitable under war conditions) of the technical organization of the bank; its reorganization may involve establishing an autonomous internal administration, setting up a separate accounting system and divorcing the position of governor from that of Minister of Finance. The liquidation of the banks of issue in occupied areas could be effected either through merger with one of the four Government banks or through re-organization as provincial institutions. These banking readjustments—as well as local currency reforms—are, in China, routine operations, in the handling of which Chinese bankers have developed exceptional skill.

Similar considerations apply to ordinary banking functions (acceptance of deposits, extension of credits and movement of funds). The participation of Government and other official institutions in this field has always been particularly important and in free China it has increased further during recent years. In northern China, the ordinary banking system has remained practically unchanged despite the war, while in central China Shanghai bankers have been able to salvage the basic institutions of the modern money market (Bankers Association, Clearing House, Joint Reserve Board), to maintain skeleton staffs and records of the branches withdrawn from the interior and to keep their cash reserves in dollar exchange. Banks throughout the country have expanded their short-term liabilities in the form of current deposits and have accumulated excess idle balances. Should these conditions still prevail at the end of the war, public and private banks would be in a position immediately to operate their branches in the interior and to resume ordinary banking operations on a national scale. It may be suggested, therefore, that the re-establishment of a working credit structure after the war should not present insurmountable difficulties.

A certain deterioration has occurred, however, in the technical organization of the credit structure. Under the impact of the war the development of organs of inter-bank operation and relationship has ceased entirely, while the process of coordination between the private credit market and the agri-

cultural, industrial and public sectors of the national economy has come to a standstill. It may be expected that the modern money market will again be faced by the same problems which confronted it in 1936-37; namely, first, in what manner funds should be provided for the traditional forms of economic enterprise (particularly petty trade and small industries); and, second, how to promote balanced readjustments between the various economic sectors of the country and to introduce new credit instruments. The lack of commercial paper and rediscount facilities will constitute one of the basic weaknesses of the credit system, although this would hardly hamper the flow of working capital to modern commercial and industrial enterprises which are financed by overdraft credit. The expanding system of co-operative organizations may be expected to provide the basis for short term bank financing of agriculture and small industries, but the introduction of adequate credit facilities from modern banks for petty trade will undoubtedly represent a more difficult task. In general, it may be expected that the credit provided by modern banks will be increasingly distributed through official channels, either by direct Government financing or by the financing of semi-official organizations on co-operative, rather than individual, security.

The Supply of Capital. The co-ordination of central banking functions under unified control and the re-establishment of a working credit structure, important as they will be, will not solve China's other major postwar financial problem—the supply of capital funds for reconstruction and development purposes in the agricultural and industrial fields. As banking liabilities consist chiefly of short term deposits and there is no investment market, modern banks are not in a position to tie up their assets in long term operations. Nor have other institutions developed with savings funds investable in long-term financing. Consequently, after the war, China's urgent and large capital requirements will be satisfied less by the application of orthodox principles of finance than by a systematic combination of special arrangements.

The possibility of raising capital is twofold, from abroad and at home. Capital from abroad may be obtained through an excess of imports of goods and services over exports, such an excess being made possible by the use of foreign exchange resources, lend-lease arrangements, foreign borrowing and direct

investments.[11] Capital at home is formed by excess of production over consumption and may be raised through voluntary savings, inflation and taxation. The extent to which any of these forms will prevail will depend upon social and political tendencies, which cannot yet be accurately foreseen.

China's foreign exchange resources consist of those Chinese-owned, easily realizable assets which are held abroad for official and private account. As official funds are part of the monetary reserves of the country and have been unavoidably drained for war purposes, their use in reconstruction work after the war is highly problematic. Private funds, on the contrary, are held abroad for security and stability of value; a considerable portion is held by or through the leading Chinese modern banks, which consider these funds as part of their cash reserves. It is in the field of rehabilitation of private industry that the Chinese private banks may be called upon, after the war, to play an important role. The possibility may be envisaged of mobilizing their foreign funds as security for the issuance of an intermediate industrial credit instrument, of the type of trust certificates in use in the United States, which could be adopted by Chinese private industry for the purchase of equipment abroad. These certificates would be issued by Chinese banks, accepted by foreign banks (on the guarantee of the Chinese banks' foreign balances) and run for terms of about five years. They would be credit instruments negotiable in China as well as abroad and they would, therefore, contribute toward introducing something in the nature of an acceptance paper in the Chinese modern money market.

The lend-lease policy adopted by the United States has brought into existence a system of international transfer of tangible values without monetary counterpart. The continuation of this policy after the war will depend not only upon the development of international political relations, but also upon

[11] The possibility of raising capital abroad through the use of current credits of the balance of payments has been purposely excluded from this study, as it is impossible to foresee the importance of overseas remittances and foreign expenditures in China's economy after the war. Estimates of China's balance of payments for the decade 1931-40 (tabulated and analyzed in the appendix) indicate that in normal years a debit balance on merchandise account and on interest and dividend payments was covered to a large extent by credits obtained from emigrants' remittances and foreign expenditures in China. However, greatly reduced remittances and foreign expenditures seem to be in prospect for China after the war.

economic and social tendencies in capital export countries, particularly in the United States.[12] Undoubtedly, lend-lease or some form of international subsidies would represent an important factor in postwar reconstruction. Any such arrangements, however, being political in nature, will probably be restricted to supplies of materials and services needed by China for social rehabilitation and public reconstruction; it is doubtful whether they will be sufficiently large to form an adequate basis for long term development work, either public or private.

In this field, capital and technical skill could be made available to China in the form of loans and direct investments. In these, the relatively new device of the Government corporation or the Government authority might very well be asssigned a major role. An international Government holding company might prove a suitable device for distributing international public lending and stimulating private investment abroad. Financial operations would be undertaken at the Governments' risk or with the Governments' guarantee; thus interest rates could be kept low and repayments spread over extended periods of time.[13] These long-term operations would have an immediate bearing upon the short term management of exchange rates; therefore, terms and modes of monetary transfer would require close co-ordination between the Central Bank of China and the central banking authorities of the creditor countries.

The only forms of visible savings in China are bank deposits and there is no developed private investment market; consequently, the process of raising capital at home by the utilization

[12] The extension after the war of lend-lease arrangements between the United States and China may find its legal basis in Art. VII of the Mutual-Aid Agreement between the United States and China, signed on June 2, 1942, which provides:

"In the final determination of the benefits to be provided to the United States of America by the Government of the Republic of China in return for aid furnished under Act of Congress of March 11, 1941, the terms and conditions shall be such as not to burden commerce between the two countries but . . . they shall include provision for agreed action . . . directed to the expansion, by appropriate international and domestic measures, of production, employment, and the exchange and consumption of goods, which are the material foundations of the liberty and welfare of all peoples."

[13] As these loans and investments in international development projects may not always bring full returns and repayment, they could not be undertaken on the basis of strict business principles. On the other hand, the lending Governments would be in a position to appraise the indirect effects of such a program on their internal economies and to bear the cost as part of their expenditures on behalf of national prosperity and international security.

of voluntary savings would require a diversion of bank resources from short-term employment to intermediate and long-term investment. Traditionally the economic basis for any developmental policy has been the adoption of a protective tariff or subsidy system; in the financial field, a decline in the short-term interest rate and an expansion of the fixed liabilities of the banks were prerequisites to the formation of an investment market. However, in the immediate post-war period, adequate technical arrangements will have to be made in order to meet the urgent need for investments. The flow of long-term credits for reconstruction and development purposes could be facilitated if the modern banks could be provided with means for meeting their short-term liabilities. This could be achieved if they were after the war to resume their participation in the financial operations of semi-Governmental agencies, such as the Agricultural Credit Administration and the China Development Finance Corporation. Such participation would introduce a general limitation and distribution of risks, as each bank would underwrite only a limited share of each credit operation for rural or industrial financing. Furthermore, arrangements could be made to the effect that bank loans and investments made through these agencies be eligible for guarantee by the National Government, for mobilization through the Joint Reserve Board, and for advances or discount at the Central Bank of China (or Central Trust of China). Such arrangements would give the banks liquidity and shiftability for their fixed assets, and remove the basic difficulty in the employment of bank resources for reconstruction and development.

But, while there need be no limit to the formation of bank credit, which may be artificially created by central bank financing operations, bank credit can be turned into productive investment only so long as labor and materials are available. Expansion of central bank credit in excess of currently available productive resources results in a flow of money larger than the flow of goods—the characteristic phenomenon of inflation. Under the pressure toward rising prices that follows, marginal resources are brought into active production and, thus, total output is expanded. The direct control of central bank credit empowers the Government to pre-empt productive resources for the purposes of State policy; in this way production can be diverted from consumption goods to capital goods, with

the result that a limitation of consumption, or forced savings, is unevenly imposed upon various classes of the population. Within limits, therefore, this expansionary procedure represents an instrument not only for raising the productive capacity of the country, but also for selectively distributing productive resources according to the Government's economic policy.

Last but not least, a tax policy may be adopted by the National Government for distributing the burden of reconstruction and development according to social and political considerations. A policy of general taxation, higher than current costs of the state require, brings about a limitation of consumption and provides the Government with revenue surpluses which may be invested in long-term reconstruction and development projects, thus adding to the total wealth of the country. A policy of specific taxation may be used for diverting the purchasing power of the public from goods which are competitive with the State's economic requirements to noncompetitive goods and services, thus augmenting the flow of production devoted to reconstruction and development purposes.

Conclusion. Probably no single method of capital raising will solve China's postwar problem, but a combination of foreign assistance and domestic effort may be the only reasonable policy. The National Government is fully aware of the opportunities for industrialization and feels the need of capital; naturally it will be tempted to follow inflationary methods and self-sufficiency, with a consequent lowering of the standard of living, if foreign capital is not made available.[14] On

[14] Authoritative views on the problem of postwar industrialization were expressed in an editorial of the influential *Ta Kung Pao* of July 14, 1942. The newspaper emphasized the fact that the agricultural type of economy is now obsolete and cannot answer problems of modern warfare; a civilization based on agriculture is bound to suffer under the strong pressure of foreign modern economies and becomes poor and belittled. This line of thought has made China realize that she will need an enormous amount of foreign capital (in the form of machinery and skilled labor) from the United Nations for a period of at least 20 to 30 years after the conclusion of the war. Therefore, the newspaper suggests that methods should be devised: firstly, with regard to the financial problem in general, to set up a strong domestic financial organization and a stable system of foreign exchange; and secondly, with regard to private capital in particular, to insure the safety of, and guarantee protection for, foreign investments in Chinese industries. See also Stein, Guenther, "Chungking Considers the Future," *Far Eastern Survey*, September 7, 1942.

the other hand, China should prepare herself for a maximum effort on the home front, as foreign assistance will necessarily be limited and might, under certain circumstances, become undesirable.

It seems probable that other foreign privileges besides extraterritorial rights will be wiped out in the course of the war, and that pre-war and war foreign loans will be adjusted or canceled at the peace conference as an international recognition of China's war effort. It may be advisable for foreign countries to undertake such steps voluntarily, in order to avoid the political controversies arising from a repudiation by China. However, new foreign assistance would continue to carry foreign influence, if no longer foreign domination. The extent to which China will accept foreign assistance will, therefore, depend fundamentally upon the international relations developed during and after the war. Furthermore, as the war progresses and expands, it magnifies the problems of reconstruction on a worldwide scale; in the immediate aftermath, capital exporting countries will probably face difficulties in meeting domestic and foreign demand for capital goods. Moreover, it may be inadvisable for China to accumulate large foreign debit balances on capital account, as they would result in heavy fixed charges in her balance of payments and, in the long run, hamper the readjustments of her international financial position.

A situation may be envisaged in which the lending Governments (especially the United States) would assure themselves that the projects to be undertaken are reasonably capable of achieving the desired results, while China would provide as much material resources and technical skill as possible and undertake the maximum responsibility for making her economic plan a success. Foreign resources should be carefully husbanded and foreign loans should be made in such form as to be disbursable only in goods and services actually needed by China and repayable in goods produced by China—similar to the past arrangements of the Export-Import Bank of Washington.[15] There should be no need for further recourse to

[15] The use of the loans of the Export-Import Bank of Washington to China is restricted at present to the payment of purchases in the United States by Chinese official agencies; the repayment of the loans is made through stipulated purchases of Chinese-produced commodities (tungsten, wood oil, tin) by American official agencies.

"currency stabilization loans" of the traditional type, as a unified and independent China should be able to protect her currency, at first by foreign exchange control and in the long run by inspiring confidence through order, prestige and economic power, not by artificially supporting exchange rates through dissipation of precious foreign resources. In this connection, financial and administrative assistance of the type granted by the United States and Great Britain through the Stabilization Board of China may be more valuable to China than the mere granting of monetary loans as such.

In the domestic field, it cannot be expected that voluntary savings from a depleted economy and taxation by a disorganized administration will cover China's urgent and large investment requirements immediately after the war. Only the use of central bank credit can provide the financial basis for full utilization of the economic resources of the country and a redirection of its productive effort from consumption goods to reconstruction and development. The degree of monetary expansion and the possibility of containing its inflationary pressure within controllable limits will depend upon the extent to which capital from abroad is contributed. However, the productive effects of an expansionary policy purposely dedicated to economic development should not be overlooked. As the capacity of the country to produce is expanded, an increased production of consumption goods will eventually counteract the inflationary pressure of monetary expansion.

It may be concluded, therefore, that after the war China will need foreign assistance in order to cover her requirements for reconstruction and development. If political conditions or economic difficulties should hamper the flow of adequate quantities of goods, equipment and skilled labor from the industrial countries, then China will have to depend upon her own resources, and endure the economic and social strain resulting from forced restriction of consumption and inflationary techniques of domestic financing.

APPENDIX

CHINA'S BALANCE OF INTERNATIONAL PAYMENTS 1931 to 1940

In the chart and tables, pp. 363-365, various estimates of China's balance of international payments for the decade 1931-1940 have been assembled and statistically arranged. Estimates for the years 1931 to 1934 were included by T. F. Koh in his study on silver.[1] The official balance of payments for the years 1933 to 1936 was made public by the Bank of China in its annual reports; private estimates for the years 1934 to 1938 were published in *Finance and Commerce* by E. Kann.[2] Certain figures for 1939 appeared in the *Ta Kung Pao* of July 6, 1940,[3] while a tentative balance of payments for 1940 was prepared by the writer on the basis of information from reliable sources.

For convenience of analysis, all figures have been converted to the present dollar gold parity (dollar with a pure gold content of 13.7142857 grains, or 0.88867091 grams) and the different items have been tabulated according to current accounts and treasure and capital account. Certain necessary readjustments have been made on the basis of information obtained from official sources or private consultations. Obviously, these estimates cannot be taken as more than an approximation subject to a wide margin of error. However, they are indicative of the basic trends which characterize China's international financial position.

China's balance of international payments is characterized by a chronic excess of imports over exports, which in ordinary times is covered to a large extent by remittances from overseas Chinese. Receipts from foreign expenditures in China usually exceed China's outpayments on account of foreign loans. China's net debit residue in current accounts is settled through inpayments from the treasury and capital account.

[1] Koh, Tsung-fei, *Silver at Work,* Shanghai, 1935, p. 23.

[2] *Finance and Commerce,* July 5, 1939.

[3] Reprinted in *The Central Bank of China Bulletin,* Summer 1940, p. 218.

Movements of silver normally represent the marginal factor compensating residual trade and service balances and non-recurrent transfers of capital.

CURRENT ITEMS

Foreign Trade. China's normal excess of imports over exports has played a major role in discussions of China's currency policies. The most important aspect of the problem is that there is actually no way of finding out exactly what the balance of trade really amounts to. Even in pre-war times, the value of imports had to be corrected for smuggling and special trade in goods over which, or in areas where, the Customs authorities could not exercise a rigid control. Estimates of the National Government's military purchases abroad had also to be taken into account in making the necessary adjustments.

Beginning in 1938, monetary factors have further complicated this picture. The monetary standard used for the valuation of imports was the Customs Gold Unit, with a theoretical pure gold content of 0.60186 grams and a theoretical exchange parity of $0.6775. In March 1938, however, the free exchange rate of the national yuan began to depreciate, but the Customs Gold Unit continued to be valued on the basis of the national yuan's official rate of 1s. 2.500 d. and was eventually arbitrarily fixed by the Central Bank of China at CN$2.707 (October 1939). To complicate the picture still further, the method of evaluating imports was not uniform. In northern China, imports were actually valued on the basis of the Federal Reserve currency, which was officially equivalent to the yen; the Customs authorities, in order to arrive at a Customs Gold Unit figure, apparently divided the Federal Reserve yuan value by the official rate of the Customs Gold Unit expressed in terms of national yuan. Exports from China were measured in yuan (national or local) according to declared values, which in pre-war years were generally assumed to be 10 or 20 per cent too low. After 1938, exports subject to exchange control by the National Government were valued according to official or trading rates, which consistently valued the yuan higher than the free exchange market quotations; exports from northern China, however, were valued at a nominal parity with the yen.

All these reservations having been made, it may still be interesting to glance at the trade figures for the decade 1931-40.

During the years preceding the outbreak of the Sino-Japanese War, an uninterrupted decline in the volume of foreign trade from $1,450 million in 1931 to $600 million in 1936 was accompanied by a contraction in the debit trade balance from $200 million-$300 million in 1931 to less than $100 million in 1936—the latter amount being covered entirely by the inflow of overseas remittances during the year. This situation was basically altered by the war, during the course of which unrecorded imports (largely for account of the military services) expanded, while exports continued to decline; consequently the annual debit balance on trade account rose to around $300 million in 1939 and 1940.

Overseas Remittances. Chinese emigrants' remittances for support of relatives, savings transfers for investment or other business purposes and welfare or war contributions cannot be estimated separately. The total of annual overseas remittances during the 'thirties was variously estimated at $90 million to $150 million, including relatively small returns received on Chinese investments abroad. There are indications that the volume of remittances, which showed a downward trend during the years 1931 to 1936, expanded again during the early years of the Sino-Japanese war.

Foreign Expenditures in China. Foreign expenditures in China include remittances for philanthropic and educational purposes from foreign sources, military and naval outlays of foreign powers with rights of extraterritoriality, diplomatic and consular expenditures of foreign States and payments by foreign shipping in Chinese waters. Most of these items are basically determined by political developments and have little connection with economic trends. Prior to 1938 the net income from these sources was sufficiently large to cover Chinese outlays for current service (covering interest and amortization) on foreign loans, for payments on foreign investments in China and rent and royalties due to foreigners (principally on motion pictures) and for official and educational expenditures abroad. After January 1, 1939, when service on foreign obligations issued before July 1937 was suspended, inpayments from foreign expenditures contributed mainly toward covering the debit balance on trade account.

This brief analysis of the current accounts of China's balance of payments indicates that during the decade 1931 to 1940 net

outpayments for trade and services exceeded net inpayments from remittances and foreign expenditures by an average of about $90 million a year. The debit residue on current account was largest during the period 1931 to 1935—owing to the deflationary pressure exercised by the rising price of silver, and during the years following 1938—owing to the diminishing flow of exports; it was smallest during the period immediately following the currency reform and monetary stabilization of 1935. This debit residue on current account was covered by the inpayments on capital and treasure account.

CAPITAL AND TREASURE

Capital Investments and Use of Foreign Credits. In the years for which estimates can be made, inpayments on capital account represented new investments, or net disbursements on foreign credits. The American cotton and wheat loans were used to the extent of $26 million during 1931 and 1933-34; repayments were scheduled over a relatively long period and eventually suspended (after 1938) on account of the Sino-Japanese war. (The service on these loans was resumed in 1942.) Many foreign undertakings—especially Japanese—were transplanted to China during the years of depreciation of the silver exchange rates and after the increase in China's import tariffs; namely, in 1931-34. Beginning in 1938, foreign credits of a political nature were made available to China. Detailed figures on the disbursements and repayments are available only with respect to the credits of the Export-Import Bank of Washington; no information is available on the use made by China of various French, Russian and British commercial and currency loans to the National Government and of Japanese credits to the Federal Reserve Bank of China and the Bank of Mongolia. The tentative estimates of total net disbursements less repayments on foreign credits include also foreign subscriptions to gold bonds issued by the National Government in 1939 and 1940.

Export of Treasure. Before November 1935, with China operating on a silver standard, gold was merely a commodity; afterward, with China on a managed paper standard, gold and silver were of value only to the extent that they could be converted into foreign exchange. These circumstances may partly account for the fact that from 1931 to 1933 gold seems to have

borne most of the strain of meeting the debit balance on current account, while in following years the rapidly diminishing availability of gold tended to deflect the burden largely, if not entirely, to silver. In 1934 the Ministry of Finance of the National Government adopted the policy of selling abroad the silver stocks, with a view to acquiring foreign exchange. While the figures of gold and silver exports in the balance of payments are the official Customs figures, a second set of figures is added for adjustment purposes, based upon estimates of the smuggling trade and of changes in the amount of bullion earmarked abroad (chiefly in London and New York) for account of the Central Bank of China.

CONCLUSION

This summary investigation into China's balance of payments indicates that China had a net debit residue in 1931, 1932, 1933, 1939 and 1940 and a net credit residue in the years 1934-38 inclusive. However, while in 1931 China imported silver in excess of its debit residue, in 1932 and 1933 exports of silver, though insignificant in absolute amounts, indicated unmistakably a turn in China's balance of international payments. Between 1934 and 1938 China liquidated abroad $374 million of silver, of which $60 million contributed toward covering residual debit balances and the remainder presumably represented accumulation of foreign exchange reserves by the Central Bank of China and of foreign assets for private account (flight of capital). After 1938, silver resources having been exhausted, the Central Bank of China was forced presumably to proceed to liquidate its foreign exchange reserves in order to cover the debit residue.

The opening of hostilities in Europe in September 1939 had a highly stimulating effect on the Chinese currency. Shanghai again became a relatively safe port for refugee capital and the national yuan became a relatively desirable currency, free from any restriction. According to various reliable sources, Hongkong capital amounting to $100 million moved into Shanghai during the latter part of 1939 and some $120 million took refuge there in 1940 from Hongkong, French Indo-China, Thailand and other areas of southeastern Asia. However, these and other floating funds hardly represented a net gain of foreign exchange; they were easily shifted into and out of the

national yuan, according to speculative opportunities. In a large sense, so long as this "bad money" remained in Shanghai, it acted somewhat like an uncontrolled and uncontrollable stabilization fund; any concurrent flight of capital from the national yuan was absorbed by this inflow of liquid funds from abroad. This phenomenon explains how China was able to cover her unprecedented debit balance and why the Chinese-British Stabilization Fund was able to support the national yuan after the middle of 1939 at a relatively stable level.

It is difficult, if not impossible, to envisage a postwar balance of payments; however, the long term trend points to a gradual deterioration of China's international financial position. While prior to 1932 the balance of payments was characterized by a net residual credit, which was covered by imports of silver, in the following years a series of residual debits resulted in an uninterrupted export of silver and flight of capital and forced China to draw increasingly upon her foreign exchange resources. The repatriation of funds, which started in September 1939, brought private foreign exchange into the hands of China's monetary authorities, who in turn disbursed it for settling debit balances abroad; this situation continued to prevail during 1940 and 1941. Greatly reduced overseas remittances and foreign expenditures seem to be in prospect for China. Consequently, with her bullion holdings entirely exhausted and her foreign exchange resources largely depleted, China may be faced after the war with extreme difficulties in meeting the debit balance on trade account which will occur if her needs for consumer and capital goods are to be satisfied through imports from abroad. Unless foreign assistance is to be forthcoming, China will be forced to maintain a severe foreign exchange control and to rely upon her domestic resources, with consequent inflationary pressure and strain on the standard of living, for whatever reconstruction or development plan is applied.

1931 - 1940

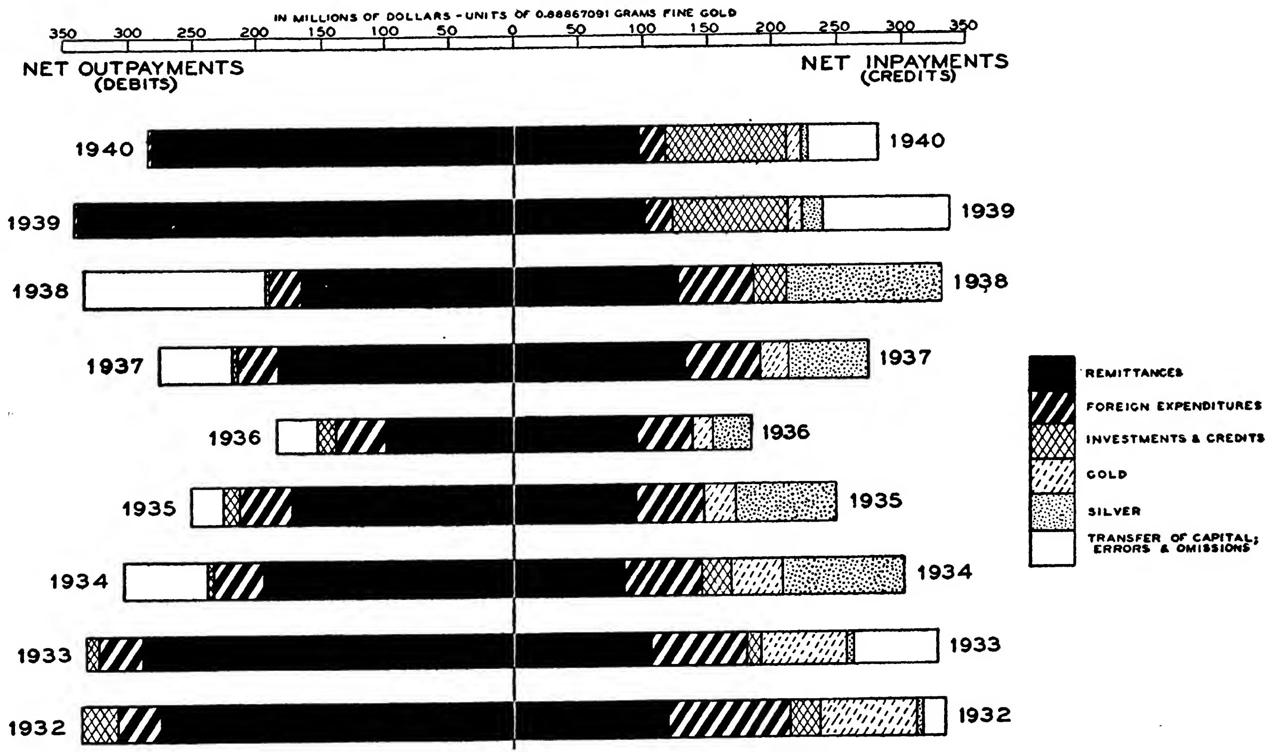
IN MILLIONS OF DOLLARS - UNITS OF 0.88867091 GRAMS FINE GOLD
350 300 250 200 150 100 50 0 50 100 150 200 250 300 350
NET OUTPAYMENTS (DEBITS)
NET INPAYMENTS (CREDITS)
1940
1939
1938
1937
1936
1935
1934
1933
1932
REMITTANCES
FOREIGN EXPENDITURES
INVESTMENTS & CREDITS
GOLD
SILVER
TRANSFER OF CAPITAL; ERRORS & OMISSIONS

TABLE 41

CHINA'S BALANCE OF INTERNATIONAL PAYMENTS

1931–1940

(In millions of dollars—Units of 0.88867091 grams fine gold)

	1931	*1932*	*1933*	*1934*	*1935*	*1936*	*1937*	*1938*	*1939*	*1940*
CURRENT ACCOUNTS										
A. *Inpayments* (credits)										
1. Export of merchandise	506.0	280.5	217.0	182.5	211.0	210.0	248.0	154.0	107.5	142.5
Smuggling, unrecorded trade and undervaluation	111.0	56.0	22.0	27.5	31.5	31.5	40.0	25.0	15.0	20.0
2. Overseas remittances	132.0	119.5	106.0	85.0	95.0	95.0	133.0	128.0	100.0	94.0
3. Income from investments and services	21.0	2.0	2.0	3.5	5.5	7.0	7.5	3.5	5.0	4.0
4. Foreign expenditures in China	95.0	102.0	76.0	61.5	55.0	47.5	63.0	61.0	28.0	28.0
Total	865.0	560.0	423.0	360.0	398.0	391.0	491.5	371.5	255.5	288.5
B. *Outpayments* (debits)										
1. Import of merchandise	813.5	597.0	477.0	351.5	336.5	280.0	278.5	243.5	355.0	345.0
Smuggling, unrecorded trade and undervaluation	17.0	12.0	48.0	52.5	77.0	60.0	191.0	100.0	105.0	97.5
2. Service on foreign loans	49.5	33.0	33.0	38.5	39.5	38.0	32.0	25.0	.5	1.5
3. Payments on investments and services	40.0	30.0	10.5	7.0	20.0	21.0	10.0	4.0	3.5	2.0
4. Chinese expenditures abroad	22.0	6.5	2.0	2.0	2.0	3.5	3.0	3.0	6.0	7.0
Total	942.0	678.5	570.5	451.5	475.0	402.5	514.5	375.5	470.0	453.0
Residue on current accounts	−77.0	−118.5	−147.5	−91.5	−77.0	−11.5	−23.0	−4.0	−214.5	−164.5
CAPITAL AND TREASURE ACCOUNTS										
A. *Net Inpayments* (credits)										
1. Capital investments and disbursements on foreign credits	16.5	22.0	10.5	24.0	..	..	..	25.0	90.0	95.0
2. Export of gold	31.0	38.5	24.5	17.5	14.0	12.0	17.0	(−3.0)	.5	1.5
Smuggling, unrecorded trade and earmarking abroad	47.0	36.5	42.5	20.5	11.0	3.0	3.5	3.0	10.0	10.0
3. Export of silver	(−26.0)	4.0	5.0	89.0	22.0	74.5	118.0	17.0	9.0	1.0
Smuggling, unrecorded trade and earmarking abroad	..	..	..	6.5	55.0	(−44.5)	(−56.5)	103.0	6.0	2.5
Total	68.5	101.0	82.5	157.5	102.0	45.0	82.0	145.0	115.5	110.0
NET DEBIT (−) OR CREDIT (+) RESIDUE	−8.5	−17.5	−65.0	+66.0	+25.0	+33.5	+59.0	+141.0	−99.0	−54.5

TABLE 41A

CHINA'S BALANCE OF INTERNATIONAL PAYMENTS—SUMMARY

1931–1940

(In millions of dollars—Units of 0.88867091 grams fine gold)

	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940
NET INPAYMENTS (CREDITS)										
1. Remittances	132.0	119.5	106.0	85.0	95.0	95.0	133.0	128.0	101.5	96.0
2. Foreign expenditures	73.0	95.5	74.0	59.5	53.0	44.0	60.0	58.0	22.0	21.0
3. Capital investments and foreign credits	16.5	22.0	10.5	24.0	..	..	..	25.0	90.0	95.0
4. Gold	78.0	75.0	67.0	38.0	25.0	15.0	20.5	..	10.5	11.5
5. Silver	..	4.0	5.0	95.5	77.0	30.0	61.5	120.0	15.0	3.5
6. Transfer of capital; errors and omissions	8.5	17.5	65.0	..	..	..	..	..	99.0	54.5
	308.0	333.5	327.5	302.0	250.0	184.0	275.0	331.0	338.0	281.5
NET OUTPAYMENTS (DEBITS)										
1. Trade	213.5	272.5	286.0	194.0	171.0	98.5	181.5	164.5	337.5	280.0
2. Service on foreign loans	49.5	33.0	33.0	38.5	39.5	38.0	32.0	25.0	0.5	1.5
3. Payments on investments and services	19.0	28.0	8.5	3.5	14.5	14.0	2.5	0.5	..	..
4. Silver	26.0	..	..	..	..	..	..	..	..	..
5. Transfer of capital; errors and omissions	..	..	..	66.0	25.0	33.5	59.0	141.0	..	..
	308.0	333.5	327.5	302.0	250.0	184.0	275.0	331.0	338.0	281.5

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The following bibliography is not exhaustive. It is limited to the most relevant published material, including books, articles and periodicals, which have been used in the preceding study and have been found to contain information relating directly to banking and credit in China. The study, however, has been largely the result of analyses of unpublished material collected by personal field work or obtained through sources and organizations, not all of which have been mentioned by name. Moreover, the preparation of the study has involved a search through a fairly wide number of publications, the interest of which lies primarily in the fields of history, political science and economics; these publications have not been included in this bibliography. Works containing general and financial statistics, such as those published by the League of Nations, and foreign periodicals of a general character have not been listed here.

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North China Star, daily, Tientsin.
Oriental Affairs, monthly, Shanghai.
Peking and Tientsin Times, daily, Tientsin.
People's Tribune, monthly, Shanghai.
Shanghai Evening Post and Mercury, daily, Shanghai.
Shanghai Times, daily, Shanghai.
South China Morning Post, daily, Hongkong.

GLOSSARY OF MONETARY SYMBOLS AND BANKING TERMS

This glossary is intended to assist the reader in the interpretation of certain monetary and banking terms not fully described in the text. The definitions refer to the terms only as used in the preceding study, and do not cover other possible meanings of the same terms.

CN$ The monetary symbol for the *national yuan*, the currency issued by the Government of the Republic of China, usually referred to as *Shanghai dollar, Chinese dollar, standard dollar, Chinese national dollar, national currency, national yuan*, etc. Since the monetary reform of November 3, 1935, the symbol stands for the currency issued by the four Government banks (Central Bank of China, Bank of China, Bank of Communications and Farmers Bank of China).

CGU The monetary symbol for the *Customs Gold Unit*, an accounting currency introduced in 1933 by the National Government for the payment of customs duties. Its theoretical gold content, originally fixed at 0.601866 grams, was revalued in April 1942 to 0.888671 grams (equivalent to the gold content of the dollar). The current exchange value of the Customs Gold Unit in other currencies is fixed by the Central Bank of China.

CR$ The monetary symbol for the *Central Reserve yuan*, the currency issued by the Japanese-dominated Central Reserve Bank of China at Nanking.

FR$ The monetary symbol for the *Federal Reserve yuan*, the currency issued by the Japanese-dominated Federal Reserve Bank of China at Peking.

HH$ The monetary symbol for the *Hua Hsing yuan*, the currency issued by the Japanese-dominated China Development (Hua Hsing) Commercial Bank at Shanghai.

Hk$ The monetary symbol for the *Hongkong dollar*, the currency of the British colony of Hongkong.

MC$ The monetary symbol for the *Meng Chiang yuan*, the currency issued by the Japanese-dominated Bank of Mongolia at Kalgan.

M¥ The monetary symbol for the *Manchurian yuan*, the currency issued by the Japanese-dominated Central Bank of Manchou at Hsinking.

¥ The monetary symbol for the *yen*, the currency of the Japanese Empire.

$ The monetary symbol for the *dollar,* the currency of the United States of America.

£ The monetary symbol for the *pound sterling,* the currency of the United Kingdom.

ARBITRAGE—The operation of buying or selling currencies or credits so as to profit by any differential exchange values prevailing in two or more markets.

BUYING RATE—The quotation at which a bank or a dealer stands ready to purchase foreign exchange against domestic currency.

CHOP—A Chinese seal or its impression; a mark attesting the purity of a coin or the legal validity of a document.

COPPER CASH—A Chinese old-style brass, bronze or copper currency, theoretically equivalent to one-thousandth of one tael.

CROSS RATE—The exchange quotation between two currencies as determined from their respective quotations *vis-à-vis* a third currency.

DISCOUNT—The sum or percentage deducted for the sale of currency or credit at a price below the nominal value fixed by law.

FICTITIOUS GOLD BARS—These, or foreign exchange, are involved in operations in which delivery or receipt of actual gold bars or foreign exchange are not called for. These operations consist of buying or selling gold bars or foreign exchange forward; they are settled on due date by either paying or receiving differences in domestic currencies.

GO-DOWN—A corruption of Malay *godong*; in Eastern Asia it denotes a warehouse.

HONG—A Chinese mercantile association or syndicate; a guild.

HSIEN—Translated as district or county; a Chinese local administrative unit of a province.

LEGAL TENDER—The attribute of a currency given by law making it valid for the discharge of monetary obligations.

LINK TRANSACTION—An operation whereby, under a system of foreign exchange control, an exporter of certain approved goods is permitted to dispose of the foreign exchange proceeds for the payment of import of certain approved goods.

LOCAL YUAN—Any currency issued under the jurisdiction of Chinese provincial government or local authorities, having legal tender attribute or a *de facto* acceptability within the provincial or local territory.

MILITARY YEN—The currency issued by the Japanese military authorities in occupied China.

PREMIUM—The excess price paid for the purchase of a currency or credit above the nominal value fixed by law.

SELLING RATE—The rate at which a bank or a dealer stands ready to sell foreign exchange against domestic currency.

SMALL MONEY—Technically, a subsidiary or fractional currency; in fact, a copper or silver local currency exchangeable at varying rates with the national currency which is commonly called in contrast, *big money*.

TAEL—A Chinese unit of weight or ounce; before 1933 the *silver tael* was used as a fictitious unit of currency, with weight, fineness and conventional value varying from place to place. The *Haikwan tael,* which was used as an accounting currency for the payment of customs duties, had a nominal weight of 583.30 grains (37.797 grams) silver, 1,000 fine, and a value of CN$1.558.

TSANGCHI—A form of industrial mortgage consisting of security on factory site, building and machinery of an enterprise.

T/T Telegraphic Transfer; T/T rate is the quotation at which funds are remitted abroad or received from abroad by cable or radio.

WEI-WAH—Literally, "to transfer"; in Shanghai banking terminology it may be translated as "clearing."

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